Banking Supervision
Tel: (+356) 21441155

16 November 2026

Dear Chief Executive Officer,

Re: Follow-up Assessment on Climate-Related and Environmental Risks: Good practices and Gaps Identified Across Maltese LSIs

1.0 Executive Summary

The Malta Financial Services Authority (MFSA) conducted a follow-up assessment of Maltese Less Significant Institutions' (LSIs) preparedness to identify, assess, monitor, and manage Climate-related and Environmental (C&E) risks following the Authority's January 2025 Dear CEO Letter and in anticipation of the implementation of the European Banking Authority's (EBA) Guidelines on the management of environmental, social and governance (ESG) risks.[1], [2] The assessment reviewed institutions' gap analyses and Board-approved remediation plans across four key areas: Materiality Assessment, Business Environment and Strategy, Governance and Risk Appetite, and Risk Management Frameworks (RMFs).

Overall, the assessment found that Maltese LSIs have made meaningful progress since the 2023/24 Thematic Review. Institutions have improved their understanding of C&E risk drivers, strengthened governance arrangements, increased Board awareness and oversight, and begun embedding C&E considerations into risk management frameworks, Internal Capital Adequacy Assessment Processes (ICAAP), and strategic planning. The Authority also observed several emerging good practices across the sector, including the use of climate scenario analysis, ESG scorecards, dedicated governance structures, enhanced risk identification methodologies, and initiatives aimed at improving data collection and reporting capabilities.

Notwithstanding this progress, implementation remains uneven across the sector and, in many cases, is still at an early stage of development. While awareness of C&E risks has increased significantly, many institutions continue to rely on high-level frameworks and remediation plans that have yet to be translated into fully operational, measurable, and forward-looking risk management practices. The assessment identified several common weaknesses, including limited use of quantitative metrics and

[1] Malta Financial Services Authority, Dear CEO: MFSA 2023/2024 Thematic Review on the Identification and Management of Climate-Related and Environmental Risks by LSIs in Malta (7 January 2025)
[2] European Banking Authority, Final Guidelines on the Management of ESG Risks (EBA/GL/2025/01) (January 2025)

materiality thresholds, insufficient mapping of C&E risks across all prudential risk categories, underdeveloped data and reporting infrastructures, weak integration within risk appetite frameworks, and limited incorporation of C&E considerations into strategic planning, capital planning, and remuneration arrangements.

Across the four assessment modules, the Authority observed the following key themes:

- **Materiality Assessment:** Institutions have generally improved the identification of physical and transition risk drivers; however, methodologies for determining materiality, defining risk thresholds, monitoring risks across multiple time horizons, and quantifying exposures remain generally underdeveloped.
- **Business Environment and Strategy:** While some institutions are beginning to incorporate C&E considerations into strategic planning processes, forward-looking resilience strategies, scenario analysis, competitive landscape assessments, and climate-related performance indicators remain insufficiently developed across much of the sector.
- **Governance and Risk Appetite:** Governance arrangements have strengthened, with greater Board engagement and clearer assignment of responsibilities. Nevertheless, the integration of C&E risks into Risk Appetite Statements, internal policies, escalation frameworks, remuneration policies, and data governance arrangements remains inconsistent.
- **Risk Management Frameworks:** Several institutions have started incorporating C&E risks into ICAAP, stress testing, and broader risk management processes. However, significant work remains to develop robust risk quantification methodologies, comprehensive risk registers, effective mitigation measures, and forward-looking capital planning frameworks.

The Authority emphasises that C&E risks are no longer an emerging or peripheral consideration for the banking sector, but a structural feature of the risk landscape. These risks affect all traditional prudential risk categories and require a comprehensive institution-wide response encompassing governance, strategy, risk management, capital planning, and day-to-day decision-making. Furthermore, institutions should not view C&E risks solely through the lens of risk mitigation or regulatory compliance. When appropriately integrated into business strategies and risk frameworks, C&E considerations can also present opportunities to strengthen long-term resilience, support the transition to a more sustainable economy, and enable institutions to better serve their customers and communities.

This is particularly relevant in the Maltese context, given the economy's exposure to climate-related vulnerabilities, including its reliance on tourism, growing pressures arising from water scarcity, and dependence on imported fossil fuels. Institutions with concentrated geographic, sectoral, or customer exposures should therefore regard the effective management of C&E risks as a core component of their long-term strategic resilience.

Looking ahead, the MFSA expects institutions to accelerate implementation efforts and progress beyond compliance-driven approaches towards fully operational, data-driven, and forward-looking frameworks aligned with applicable EBA, ECB, and MFSA expectations. Priority areas include strengthening data capabilities, enhancing scenario analysis and stress testing practices, developing meaningful climate-related metrics and thresholds, embedding C&E risks within governance and risk appetite frameworks, and integrating these considerations into capital planning and strategic decision-making processes.

C&E risks will increasingly form part of supervisory activities and institutions that fail to adequately address identified shortcomings may be subject to heightened supervisory scrutiny and potential supervisory measures. Accordingly, banks are expected to treat the development of robust C&E risk management frameworks as a strategic priority that supports both regulatory compliance and long-term resilience.

2.0 Background and Scope

The management of C&E risks continues to evolve as a key component of the European prudential framework. In line with increasing regulatory and supervisory expectations, institutions are expected to develop robust frameworks for identifying, assessing, monitoring, and managing C&E risks across their business activities, governance arrangements, and risk management processes.

In 2022, the MFSA participated in the European Central Bank's (ECB) Thematic Review on Climate-related and Environmental Risks, which included a sample of Maltese Less Significant Institutions (LSIs). The exercise assessed institutions' preparedness against supervisory expectations in the areas of Materiality Assessment (MA), Business Environment and Strategy (BES), Governance and Risk Appetite (GOV), and Risk Management Frameworks (RMF).[3] Following this exercise, the Authority issued a Dear CEO Letter in December 2022 outlining key supervisory expectations and minimum deliverables to support the gradual integration of C&E risks within institutions' governance, risk management, and strategic planning frameworks.

Building on this work, the MFSA issued a further Dear CEO Letter on 7 January 2025, requesting LSIs to conduct a comprehensive gap analysis against the findings of the 2023/24 Thematic Review and relevant ECB expectations, and to submit a Board-approved remediation plan outlining specific actions and implementation timelines.

The Authority subsequently reviewed the gap analyses and remediation plans submitted by LSIs to assess institutions' preparedness for the implementation of the EBA Guidelines on the Management of ESG Risks and their alignment with applicable supervisory expectations. Individual feedback letters were issued to institutions highlighting observed progress and identifying areas requiring further enhancement.

[3] Malta Financial Services Authority, Dear CEO Letter – Climate-Related and Environmental Risks Preparedness (December 2022)

The assessment was undertaken with reference to, inter alia, the ECB's *Guide on Climate-related and Environmental Risks*, the EBA's *Guidelines on the Management of ESG Risks*, and the evolving prudential requirements introduced through CRR III and CRD VI.[4] These frameworks emphasise the integration of ESG risks within governance arrangements, risk appetite frameworks, ICAAP processes, scenario analysis, stress testing, business strategies, and capital planning.

The review focused on the adequacy, comprehensiveness, and proportionality of institutions' approaches to identifying material C&E risks and embedding such risks within existing risk management and control frameworks. Attention was given to methodologies for assessing materiality, governance and oversight arrangements, risk data and reporting capabilities, scenario analysis and stress testing practices, and the credibility and feasibility of proposed remediation actions.

The assessment also considered the extent to which institutions have incorporated C&E considerations into strategic and business planning processes, including portfolio monitoring, concentration risk assessments, the development of relevant risk metrics and limits, and Board and senior management oversight arrangements. Institutions were expected to demonstrate governance structures and reporting processes that are commensurate with the nature, scale, and complexity of their activities.

The purpose of this letter is to communicate the key observations arising from the assessment, share examples of practices observed across the sector, and highlight areas where further enhancement is required. Institutions are expected to take due consideration of the observations outlined herein and continue strengthening their frameworks to ensure the effective and timely management of C&E risks in line with applicable regulatory and supervisory expectations.

3.0 Overview of Findings from Gap Analyses and Remediation Plans

This section outlines the findings across the four core modules: Materiality Assessment, Business Environment and Strategy, Governance and Risk Appetite, and Risk Management Frameworks. A framework based on the EBA Guidelines was developed to assess the 21 items across the four modules, taking into account both the Gap Analysis and Remediation Plan. Each item was assessed using four rating categories: Adequate, Satisfactory, Weak and Inadequate.

3.1 Materiality Assessment

The Materiality Assessment is a structured process that identifies the C&E risks critical to the Bank's overall business portfolio and serves as the cornerstone to develop sound strategies and risk management frameworks. Figure 1 below shows that banks have recorded progress in identifying risk

[4] European Central Bank, Guide on Climate-related and Environmental Risks (November 2020)

drivers and linking them to prudential risk categories. However, the identification of metrics and setting clear materiality thresholds remain underdeveloped.

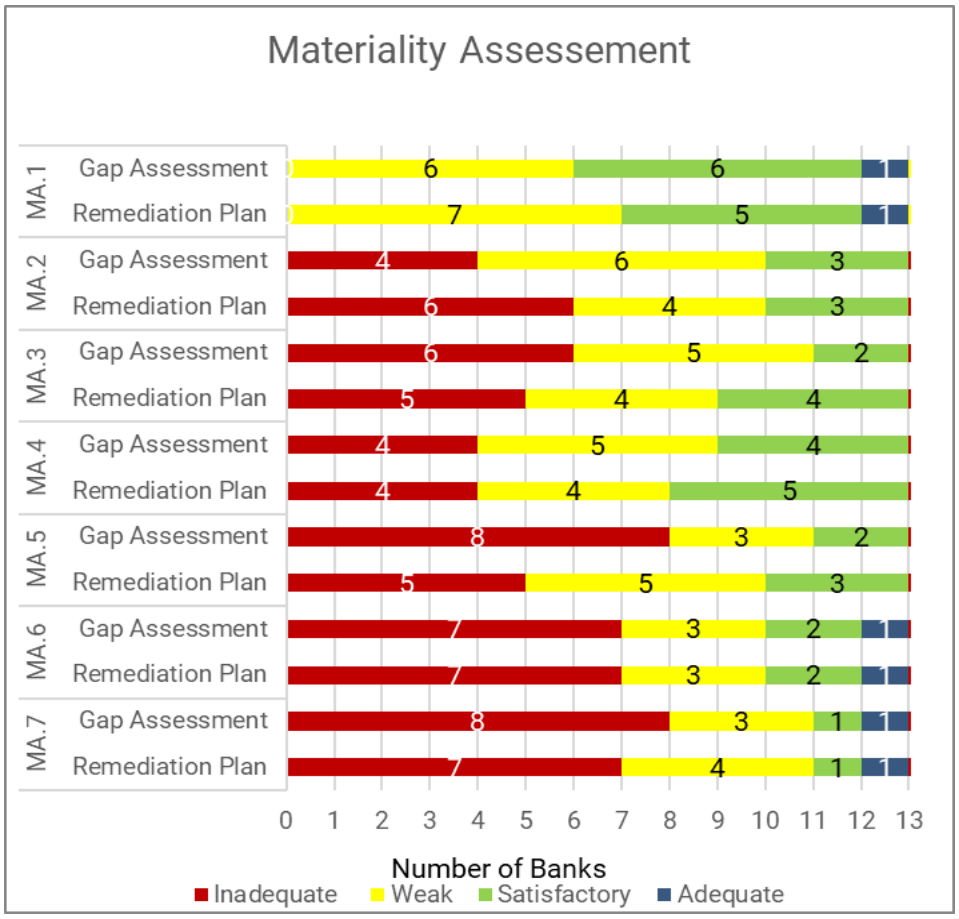


Figure 1. Findings from Materiality Assessment

Module: Materiality Assessment	
MA.1	Identification of Risk Drivers
MA.2	Identification of Transmission Channel Affecting all Prudential Risk Categories
MA.3	Use of Qualitative Metrics
MA.4	Use of Quantitative Metrics
MA.5	Monitor Climate & Environmental Risk Drivers under Multiple Time Horizons (Short-, Medium- and Long-Term)
MA.6	Clear Thresholds to Determine When a Risk Driver Becomes Material
MA.7	Quality and Source of Data Used for Conducing the Assessment

Table 1 – Materiality Assessment[5]

[5] The assessment covered 21 items across four modules — Materiality Assessment; Business Environment and Strategy; Governance and Risk Appetite; and Risk Management Framework — reflecting the priority areas on which the Authority expects institutions to focus. Each item was assessed across four rating categories (Adequate, Satisfactory, Weak and Inadequate) and two dimensions:

3.1.1 Identification of Risk Drivers (MA. 1)

The identification of risk drivers was varied across the local LSIs, with most institutions making tangible progress compared to the previous Thematic Review. Most LSIs presented a comprehensive set of risk drivers mapped according to their physical and transition risk which indicates a thorough review of the individual banks' business lines and portfolios. A few notable observations were the development of an ECL impact analysis across time horizons and internal scoring methodologies to assess exposures, which helps banks monitor the evolution of physical and transition risk drivers in terms of their severity and frequency and quantify their impact on the business.

Some institutions failed to conduct robust materiality assessments capturing non-material as well as potentially emerging risks. A common deficiency identified across institutions was the absence of a systematic mapping of all potential C&E risk drivers, including emerging risk drivers that may become material over time. In addition, many institutions had not established clear criteria for determining when changes in the severity or frequency of such risk drivers should trigger a reassessment of materiality. Moreover, even though several local LSIs have foreign exposures, risk drivers did not cover all geographies and markets in which the bank operates, and maintain a short-term focus, without adequate coverage of medium- and long-term horizons. This could limit the understanding of the risk at which the business model could be eventually affected, missing to provide valuable information to foster the resilience of the business model and the overall bank's strategy.

The Authority reminds banks that the Materiality Assessment needs to be conducted for all traditional risk categories that the institution is exposed to, including credit, market, operational, reputational, liquidity, business model and concentration risks, as well as taking into account acute physical risks (flooding, wildfires, heatwaves, etc.) and chronic physical risks (rising sea levels, persistent droughts, etc.), and transition risks. This should cover all portfolios that are impacted in terms of revenues, profits and exposures. Sectors that contribute highly to climate change, geographical areas where counterparties and physical collateral are held, and business model which could be affected by this transformation, should also be considered. The assessment should draw on appropriate analytical tools, including sectoral analysis, geographical risk mapping, overview of market and regulatory developments, and vulnerability to natural hazards, supported by quantification of climate risks and at least a proxy-based quantitative assessment of other environmental risks, tracked through key risk indicators. At a minimum, a qualitative scoring of the potential impact on each traditional risk category is expected, underpinned by regular board-level discussion informed by initial high-level quantitative data. On this basis, the institution should arrive at a clear and well-reasoned conclusion as to whether each risk category is materially impacted by climate and nature risk drivers, consistent with the expectations set out in the EBA Guidelines.

3.1.2 Identification of Transmission Channels Affecting Prudential Risk Categories (MA. 2)

The extent to which institutions identify transmission channels to map C&E risk drivers across prudential risk categories was found to be insufficient across nearly 75% of the Maltese LSIs. The other 25% of institutions incorporated the mapping of C&E risks across the main prudential risk

- Gap Assessment — reflecting the institution's level of preparedness as at June 2025;
- Remediation Plan — reflecting the institution's planned actions to achieve full compliance with CRD VI, the EBA Guidelines and MFSA's expectations, and to support a broader cultural shift and long-term resilience.

categories, namely credit risk, market risk, operational risk, liquidity risk, and reputational risk. Although the level of granularity of the mapping differs among these institutions, their approaches demonstrate a more comprehensive framework for identifying and monitoring transmission channels. This framework is subject to regular review and is integrated into the ICAAP process to assess whether further enhancements to the identified transmission channels are required.

The MA of the rest of the LSIs still lacks the definition of a clear linkage between C&E risks and the prudential risk categories, thus limiting banks from developing more robust Risk Management Frameworks. A notable observation is that a number of LSIs presented a more developed credit risk assessment, with other prudential risk categories mentioned but not explicitly mapped. Banks with lending as one of their main business lines focus on the impact of C&E risk drivers on collateral, sectoral CO_2 exposure and capital allocation, with a minority of banks planning to address physical risks as well transition risks, through stress testing the collateral values of commercial and residential real estate in vulnerable areas.

At this stage, it is expected that both transition and physical risks are mapped across all risk categories that the bank is exposed to and with impacts on credit spreads, collateral values, market repricing and operational disruptions feeding into risk models and into the calibration of the Risk Appetite Statement. The assessment should take into account acute physical risks, such as flooding and heatwaves, and chronic physical risks such as rising sea levels as well as transition risks, for example: changes in policies, regulation or technologies that stem from a shift toward a low-carbon economy, impact on energy price and the resilience of the economy the bank serves.

3.1.3 Use of Qualitative and Quantitative Metrics (MA. 3 and MA. 4)

The Authority identified remaining gaps in defining qualitative and quantitative metrics to assess C&E risk, data sources or breakdown by sector, geographies and products across different time horizons as shown in items MA.3 and MA.4 in Figure 1 above. In the majority of the self-assessments presented to the Authority, LSIs missed to provide evidence vis a vis the metrics being considering and how these are monitored, data sources, and proxies opted to be monitored in case the desired metrics would not be directly observable. Moreover, the link between results and decision-making is still weak beyond credit risk and there is a lack of clear description of how such outputs are being integrated in the broad Risk Management Framework, Risk Appetite Statement (RAS) and ICAAP.

Nonetheless, the remediation plans of a few LSIs are promising and include data collection from EPC certificates and energy consumption data as well as estimates of physical risk exposure such as rising sea levels, floods, and tsunamis. A particular bank is also developing an ESG Scorecard which will be implemented in the credit assessment process to gather data from clients and consider ESG factors during credit granting and assessment processes which shows that such risks are being considered in decision-making.

Other good practices observed during the Authority's assessment include:

- the development of an internal scoring system to assess the severity of physical risk associated with weather-related events, such as earthquakes and extreme heat;
- quantitative metrics in place for ECL under climate-related scenarios, IRRBB under climate pathways, and acute physical operational risk using hazard probability assessments;

- evaluating sovereign bond exposures for downgrade risk based on national emission intensity or the vulnerability or the dependency of their economy to climate factors as well as the linkage of C&E factors to both market and credit risk;
- using data from external credit ratings on borrowers, collateral and financial assets to calculate potential losses in case bank facilities are affected by transition risk; and
- analysis drawing from national risk assessments, official sources, independent and historical climate data sources to conduct a risk assessment across all operating locations evaluating adverse scenarios that could affect premises, infrastructure, technology, and staff based on likelihood and impact and resulting in an inherent risk rating.

3.1.4 Monitoring of C&E Risk Drivers under Multiple Horizons (Short-, Medium- and Long-Term) (MA.5)

Most of the Maltese LSIs did not address how they intend to monitor the impact of C&E risks on prudential risk categories and profitability over the short-, medium- and long-term horizons. A common deficiency was that assessments focus solely on the short term and do not sufficiently cover all risk types and portfolios, resulting in limited forward-looking risk controls.

Good practices for monitoring C&E risk drivers under multiple horizons include the development of a methodology which allows the institution to monitor the development of risk drivers, KPIs and KRIs across the short-, medium- and long-term, thus allowing the bank to understand the impact on the business model and strategy, including capital level, profitability and revenue sources. A strong remediation plan is one that incorporates materiality thresholds into risk dashboards and the ICAAP, differentiated by prudential risk category, for example, expected credit losses for credit risk or the percentage of exposure at risk for operational risk. These thresholds should be accompanied by clearly defined triggers for management action and capital decision-making, as well as robust and evidenced justifications, both quantitative and qualitative, for any immateriality determinations.

For full compliance with the EBA Guidelines, the Authority expects LSIs to have granular data as well as forward looking quantitative data including proxies for the short- and medium- term horizon, and at least a qualitative assessment of long-term trends and impacts for the long-term horizon.

3.1.5 Clear Thresholds to Determine When a Risk Driver Becomes Material (MA. 6)

Similar to the point above, the self-assessments of most LSIs highlight the absence of materiality thresholds or a methodology for distinguishing between material and immaterial risk drivers, which also indicates a lack of a defined escalation process should conditions change. The absence of such thresholds limits the institution's ability to proactively identify emerging risks and to respond in a timely and structured manner. More positively, a limited number of banks described how they carried out an overview of their lending portfolio and determined which risks are material, defining how they arrived at these conclusions, supported by data and portfolio-specific adjustments. Remediation includes a plan to define a set of qualitative and quantitative C&E thresholds to integrate physical and transition risks into monitoring frameworks.

Further good practices that the Authority expects include setting materiality thresholds by risk type, such as expected credit losses for credit risk or the percentage of exposure at risk for operational

risk. These should be aligned with the bank's portfolio composition and integrated into early warning signals and risk dashboards.

3.1.6 Quality and Source of Data Used for Conducting the Assessment (MA.7)

Whilst acknowledging the challenges in accessing high quality data sources, a small number of LSIs made use of a combination of internal data, external sources, and academic research across multiple time horizons, ensuring that their data framework remains robust, relevant, and reliable. In general, LSIs have started gathering data and integrating some external inputs, but these remain fragmented, and lack granularity and scientific alignment, thus constraining banks' ability to adequately assess physical and transition C&E related risks.

As a matter of best practice, banks should seek to obtain high-quality and validated data from internal and external sources, to be used consistently across the relevant time-horizons, and to support risk assessments, thresholds setting and scenario analysis. Examples of practices that may support institutions in strengthening their assessments include the use of emissions intensity data, macroeconomic projections, NGFS transition scenarios and relevant physical risk datasets.

To ensure alignment with EBA Guidelines, the Authority expects assumptions to be based on substantiated reasoning, including regular Board discussions on effects of C&E risks based on quantitative data and a qualitative scoring of the potential impact (low, medium, high) on each prudential risk category.

3.2 Business Environment and Strategy

This module centres around the environment in which the bank operates and includes internal and external factors ranging from C&E risks to regulatory expectations that may influence a bank's sustainability. The strategy involves long-term planning aimed at enhancing resilience and viability of the business model. As illustrated in Figure 2 below, LSIs have faced challenges in assessing the business environment in which they operate, establishing relevant KPIs, and developing forward-looking strategies to adapt their business models under different scenarios and strengthen institutional resilience. Nevertheless, remediation efforts are currently underway.

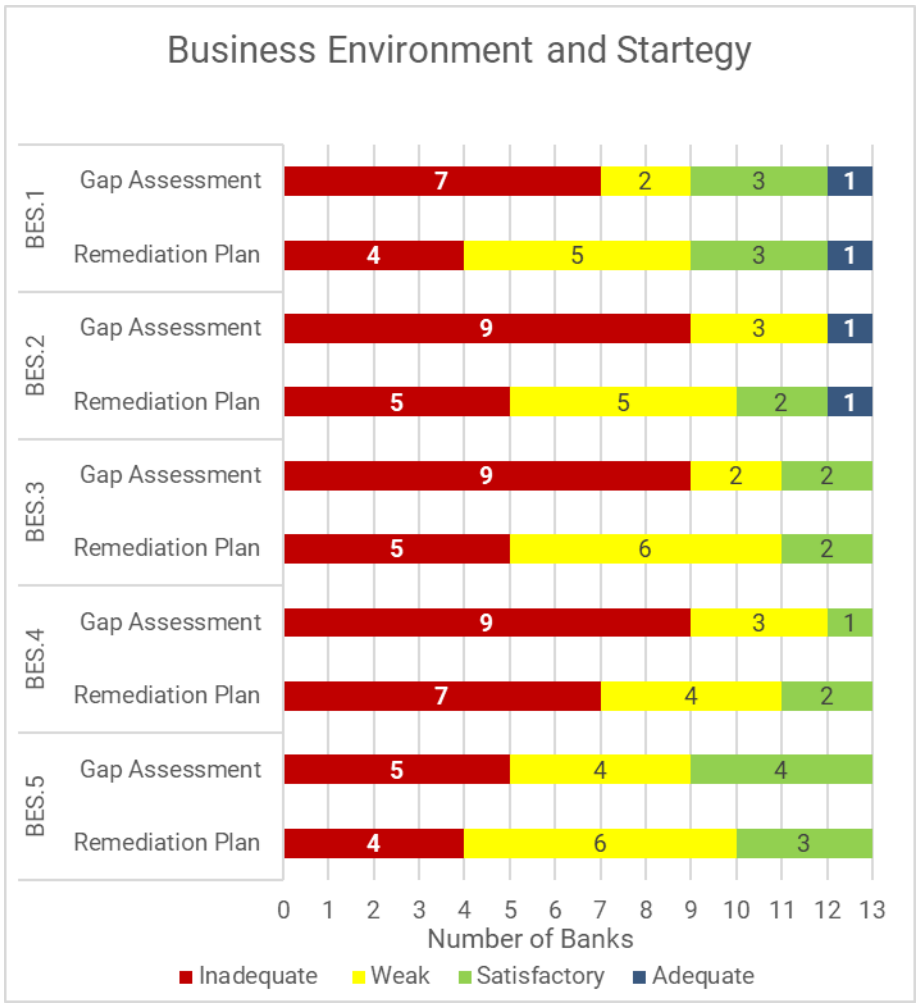


Figure 2. Business Environment and Strategy

Module: Business Environment and Strategy	
BES.1	Monitoring of Climate-related and Environmental Risk Impact on Business Environment
BES.2	Definition of Relevant KPIs
BES.3	Definition of Forward-Looking Resilience Strategy
BES.4	Business Environment & Competitiveness Landscape Assessment
BES.5	Use of Scenario Analysis and Stress Testing

Table 2 – Business Environment and Strategy

3.2.1 Monitoring of Climate-Related and Environmental Risk Impact on Business Environment (BES.1)

Similar to the findings of the 2024 Thematic Review, more than half of LSIs still lack a structured process to analyse or monitor vulnerabilities stemming from C&E risks. The absence of such monitoring may create blind spots in strategic planning, even where current exposures appear limited.

Common shortcomings include static rather forward-looking monitoring, with underdeveloped methodologies and metrics, thus lacking actionable management responses.

Nevertheless, banks have demonstrated positive progress in this area. For example, certain institutions monitor C&E risks through their Risk Appetite Dashboard, while one bank has developed an internal tool to track macroeconomic and market developments relevant to its business lines, including energy prices, GDP growth, the Real Estate Price Index, and climate-related policy developments. Promising remediation initiatives also include the integration of C&E risk drivers and strategic targets into risk appetite and risk management frameworks, as well as the development of data tools to assign climate-related risk scores to customers.

The Authority expects banks to move beyond high-level intentions and establish operational, forward-looking, and strategy-linked monitoring systems, ensuring that C&E risks are actively managed rather than passively observed. This should be achieved through concrete and time-bound actions to ensure that these insights are systematically integrated into scenario analysis, stress-testing and strategic reviews, supported by an appropriate governance framework and embedded into ongoing business operations.

3.2.2 Definition of Relevant KPIs (BES. 2)

While some institutions have begun integrating C&E related metrics, KPI frameworks remain at an early stage of development and are often insufficiently risk-focused and forward-looking. As shown in Figure 2, most LSIs do not have any KPIs to monitor C&E risks and risk tolerance levels are not yet integrated into the Risk Appetite Statement or credit policies, resulting in a lack of actionable strategic targets. Banks often lack KPIs that capture borrower vulnerability, affordability pressures and geographic concentration risks, which limits their ability to assess their portfolios and anticipate credit quality deterioration.

Observed good practices by some institutions include establishing related KPIs such as the Green Asset Ratio and setting strategic targets such as increasing exposure to green assets by 2030. Positive remediation actions include the assessment of carbon intensive segments and portfolio rebalancing strategies, demonstrating an emerging link between risk identification and a sustainable strategy.

Although banks acknowledge the need to develop KPIs aligned to risk drivers and specific vulnerabilities, the Authority highlights the need to base KPIs on forward-looking, time-bound targets consistent with banks' business strategy and capital planning. In line with EBA expectations, effective KPIs should capture both physical and transition risk drivers and their transmission into prudential risks. This will enhance banks' forward-looking capability through links to stress testing and decision-making.

To be effective, KPIs need to be linked to the bank's long-term strategy. Well-defined and properly monitored KPIs are essential to understanding what success in pursuing that strategy looks like. KPIs should therefore be set with targets aligned to the bank's broader long-term strategy, structured around specific time horizons, and translated into actionable annual targets defined by the institution.

Where targets are expressed as a percentage variation, they should be anchored to a clearly defined base reference amount (e.g., a year-on-year 10% increase in the Green Asset Ratio, measured against the balance sheet amount at the previous year-end).

KPIs must be relevant to the management of C&E risk and linked to both business strategy and prudential risk categories. KPIs that are merely "nice to have" are not sufficient to meet supervisory expectations and drive affective change.

3.2.3 Definition of Forward-Looking Resilience Strategies (BES. 3)

A forward-looking resilience strategy should not be understood merely as a risk mitigation exercise. Banks are expected to take an active role in the transition, positioning their business model to capture emerging opportunities and to strengthen the resilience of the economies they serve against external shocks. Viewed this way, the long-term strategy becomes a driver of future business model evolution, enabling institutions to identify new trends, reposition their portfolios accordingly, and contribute to the broader resilience of the real economy, rather than a purely defensive response to C&E risk.

Another limitation identified in the assessment of banks' gap analyses is the incomplete transition to a forward-looking resilience strategy. LSIs often fail to articulate how business models, portfolios, or capital allocation will adapt under different scenarios and the use of scenario analysis is limited. As mentioned previously, banks often lack clearly defined KPI/KRI thresholds linked to escalation processes and thus there is no mechanism to trigger a concrete strategic response, whether defensive or opportunity driven.

Nonetheless, a few banks have made notable progress by incorporating climate-related scenario analyses into their ICAAP/ILAAP process and applying NGFS-based scenarios to assess capital and liquidity impacts, asset quality and profitability. The Authority has reviewed cases where banks considered transition risk timelines and the alignment of loan maturities, as well as their physical risk exposure, considering both chronic and acute climate scenarios across borrower locations. The implementation of preferential pricing for energy efficient buildings represents a shift from a risk identification approach towards operationalisation.

The Authority expects institutions to translate scenario analyses into concrete, actionable strategies, supported by robust governance, trigger mechanisms, and integration into core decision-making, to ensure long-term resilience under evolving C&E risks. Beyond ensuring long-term resilience under evolving C&E risks, this should also enable institutions to identify and capture emerging opportunities arising from the transition, reinforcing both their own long-term viability and sustainability, as well as the resilience of the economy they serve. Banks are thus expected to adopt a forward-looking resilience approach supported by scenario analysis, reflecting climate-related macroeconomic shocks (e.g. energy price increases, inflationary pressures or regulatory changes), assessing the potential impact on borrower affordability, credit performance and overall business resilience across short-, medium- and long-term horizons.

3.2.4 Business Environment and Competitive Landscape Assessment (BES. 4)

The review of the gap analyses related to the business environment and competitive landscape assessment revealed that all LSIs place insufficient emphasis on competitive dynamics and lack structured monitoring of peer strategies and an analysis of their market positioning in C&E related products. Similarly, Business Environment Assessments often focus mostly on internal and macroeconomic factors while neglecting market structure changes, peer strategies and customer behaviour not only within the Maltese context, but also in relation to key trends across the broader European market. A forward-looking perspective of how C&E risks may reshape markets and how transition may affect competitiveness is also missing.

The Authority acknowledges that a minor number of banks demonstrated sound practices by conducting a Business Environment Assessment and embedding the outcomes in the Risk Appetite Statement and credit origination processes such as responsible lending policies, an ESG scoring matrix, etc. Some institutions are also moving towards linking outputs from their Business Environment Assessment into strategic reviews and incorporating competitive benchmarking and policy impact analyses into their remediation plans.

The Authority expects banks to move beyond internally focused analyses and adopt a holistic, forward-looking view of external dynamics, ensuring that competitive, regulatory, and customer-driven changes are systematically monitored and fully integrated into strategic decision-making and risk management frameworks. Further identification of how peers are acting is needed to avoid potential pressure on the business model, a reduction in market share, and threats to business viability and sustainability in the medium- and long-term.

3.2.5 Use of Scenario Analysis and Stress Testing (BES. 5)

Some institutions demonstrate growing maturity in the use of scenario analysis and stress testing by leveraging recognised frameworks (e.g. NGFS, ECB methodologies) and embedding climate scenarios within their ICAAP/ILAAP processes. Some banks assess impacts on key prudential metrics such as capital, liquidity, profitability and asset quality, and in some cases incorporate both transition and physical risks. Encouragingly, some institutions have begun linking scenario outputs to strategic decision-making, including pricing, product design and business model considerations, signalling a gradual shift toward operationalisation. Remediation plans are often sound, aiming to expand scenario coverage, enhance methodologies, and align with evolving EBA requirements, including the introduction of climate resilience analysis and integration into transition planning.

Notwithstanding these developments, significant gaps persist across the sector. Scenario analysis remains narrow in scope, frequently limited to transition risks and credit risk impacts, with insufficient incorporation of other prudential risks. Several banks have yet to implement any meaningful scenario analysis, highlighting a lack of forward-looking perspective in business planning. Methodologies are often underdeveloped with limited data foundations, and insufficient definition of short-, medium-, and long-term horizons. Crucially, the integration into strategic decision-making, risk appetite, and capital planning remains partial, with outputs rarely translating into actionable management responses.

In line with EBA Guidelines, the Authority expects institutions to ensure scenario analysis is tailored to the bank's risk profile and business strategy and covers all material risk categories to be able to assess profitability. Outputs should be capable of informing strategy, capital planning, and long-term resilience in line with evolving C&E risks.

3.3 Governance and Risk Appetite

This module tackles the structure and processes of the Management Body in its responsibility to oversee the identification, management and monitoring of C&E risks, ensuring their integration into strategy. LSIs mostly assigned responsibilities in their organisation through formally structured committees. However, they do not align this with actions in the Remuneration Policy and Risk Appetite Statement, as Figure 3 shows.

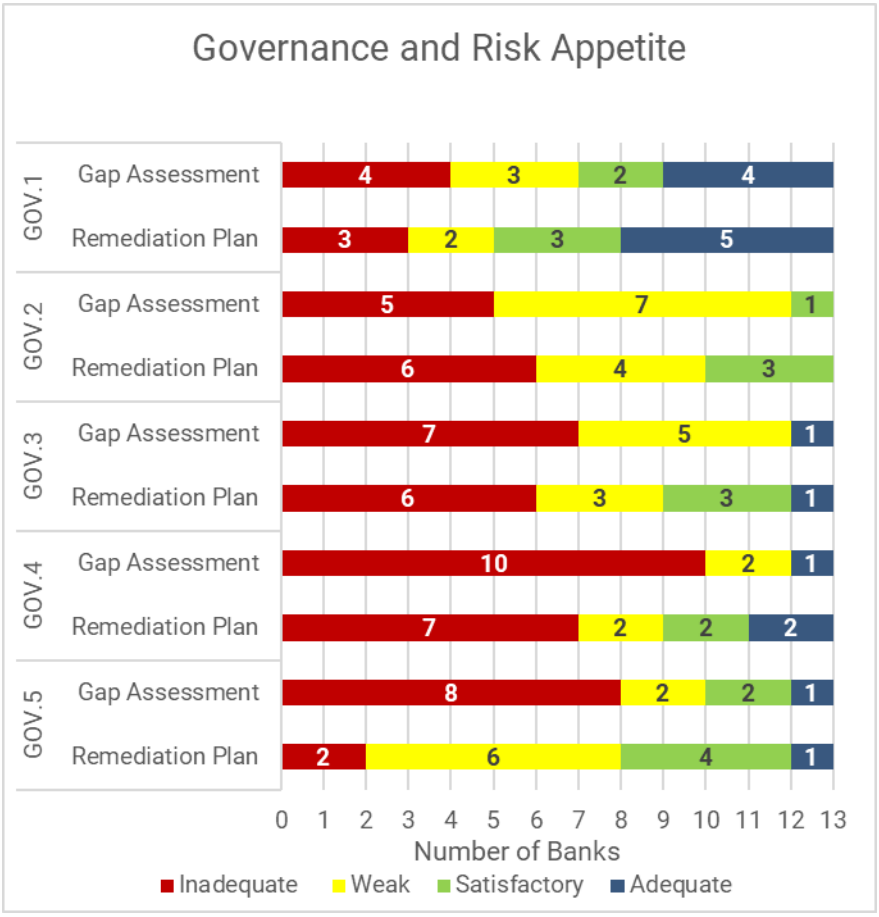


Figure 3. Governance and Risk Appetite

Module: Governance and Risk Appetite	
GOV.1	Establishment of Dedicated ESG Committee and Assignment of Specific Role
GOV.2	Data, Reporting Infrastructure and IT system
GOV.3	Integration of C&E Risk Consideration in Internal Policy, Governance Framework and Established Effective Escalation Procedures
GOV.4	Remuneration Policy included ESG considerations (including KPIs and KRIs)
GOV.5	C&E risk consideration in RAS

Table 3 – Governance and Risk Appetite

3.3.1 Establishment of a Dedicated ESG Committee and Assignment of Specific Roles (GOV. 1)

The Authority positively notes that four LSIs have established committees with representation from Board members and key executives, maintaining documented minutes. The institutions assessed as 'Adequate' or 'Satisfactory' also integrate C&E risks across their Three Lines Model with defined roles across risk, customer-facing staff, internal audit, etc, further driving the implementation of related requirements. These practices are further strengthened where banks demonstrate ongoing training initiatives, Board engagement, and structured remediation plans to enhance clarity of responsibilities and awareness.

In other institutions, the absence of dedicated ESG committees or formal governance structures is observed, and this limits accountability and ownership. The gap analysis and documentation provided by banks show that C&E risk oversight is often addressed informally or embedded within general risk discussions. The Authority also identified instances where C&E risks are not formally addressed at Board level, possibly indicating gaps in knowledge and training. Weak integration across the Three Lines Model was also identified.

To address the identified gaps, the Authority expects institutions to establish robust, clearly structured governance frameworks for C&E risks, ensuring that roles and responsibilities are formally defined across the Board, Senior Management, and the Three Lines Model. This includes strengthening accountability, coordination, and escalation mechanisms, enhancing the collective expertise of the management body through ongoing training, and ensuring that governance arrangements effectively support the integration of C&E risks into strategic decision-making and risk management processes, in full alignment with EBA Guidelines.

3.3.2 Data, Reporting Infrastructure and IT System (GOV. 2)

A few institutions have taken initial but meaningful steps to enhance their data capabilities, including the collection of client- and asset-level information (e.g. EPC ratings, physical risk indicators) and the use of external data providers and tools. In LSIs demonstrating good practices, C&E risk considerations have been embedded into credit processes and internal methodologies, supported by early-stage monitoring tools including internally developed solutions. These efforts, together with remediation plans acknowledging data gaps and the need for improved infrastructure, demonstrate growing awareness of the importance of robust data frameworks to support C&E risk management, reporting, and disclosures.

Despite these developments, data, reporting, and IT infrastructures remain largely underdeveloped across institutions. Most banks rely on manual, fragmented, and non-scalable solutions (e.g. spreadsheets), with limited automation and weak integration across business lines and risk systems. Data governance is often insufficiently defined, with unclear ownership, weak validation processes, and inconsistent data quality, including reliance on proxies and static tools that do not support forward-looking analyses. Furthermore, ESG data is not consistently integrated into core risk management processes or reporting frameworks, with limited escalation to the Board.

The Authority expects institutions to develop data infrastructures capable of capturing, validating, and aggregating granular C&E risk data across all material portfolios and business lines. These systems should be supported by robust data governance frameworks, clear ownership, and strong quality controls, and should enable timely internal reporting, regulatory disclosures, and a forward-looking risk analysis. Banks are also expected to enhance data coverage with reliable external sources and standardised metrics, progressively reducing reliance on proxies, and to ensure full integration of ESG data into ICAAP, credit risk assessments, strategic planning, and Board-level reporting.

3.3.3 Integration of C&E Risk Consideration in Internal Policy, Governance Frameworks and Established Effective Escalation Procedures (GOV. 3)

A few LSIs demonstrate strong remediation plans in this area, such as updating their full policy suite across key prudential risk areas such as credit, operational, and market risk. Positive developments include the introduction of ESG questionnaires, sectoral concentration limits, enhanced pricing methodologies, and integration of C&E considerations into credit risk frameworks, including collateral valuation and onboarding processes. In several cases, remediation plans outline a holistic and

structured approach, including defining escalation thresholds, strengthening the Three Lines Model, and incorporating C&E risks into business continuity planning and reputational risk management. These efforts indicate a shift towards a more comprehensive and operational integration of C&E risks, supported by governance alignment and periodic monitoring.

Despite these developments, integration of C&E risks into internal policies and governance frameworks remains largely incomplete and high-level across institutions. Many banks either lack a formal gap analysis or remediation plan or have only partially embedded C&E considerations within policies, often limited to general references, without clear application to risk management practices. KRIs are frequently overly simplistic and not sufficiently granular, failing to capture the impact of physical and transition risks across portfolios and business unit/products. There is also a lack of defined escalation procedures, thresholds, and ownership, as well as limited linkage to key risk metrics such as Probability of Default, Expected Loss, and collateral valuation. Internal reporting often does not adequately reflect the impact of C&E risks on business strategy and risk profiles, and governance frameworks lack consistent operationalisation, testing, and review mechanisms, resulting in fragmented and ineffective implementation.

The Authority expects banks to fully integrate C&E risks into their internal policies, governance frameworks, and escalation processes through a structured end-to-end approach. This includes updating all relevant policies (particularly credit, operational, and market risk) to clearly articulate how C&E factors influence risk metrics, defining granular KPIs/KRIs cascaded across portfolios, and establishing clear escalation thresholds, responsibilities, and reporting lines within the Three Lines Model. Institutions should ensure that C&E risks are operationally embedded in decision-making processes, supported by robust internal reporting, regular testing and a review of escalation mechanisms.

3.3.4 Remuneration Policy Including ESG Considerations (including KPIs and KRIs) (GOV. 4)

A limited number of institutions demonstrate initial alignment of remuneration frameworks with ESG considerations, including references to ESG values and early plans to introduce C&E related KPIs and KRIs for senior management. In some cases, banks are beginning to link sustainability objectives with performance management, supported by remediation efforts to incorporate measurable indicators into the Risk Appetite Statement and align remuneration with broader sustainability strategies.

However, most LSIs fall significantly short of supervisory expectations. Remuneration policies often either do not include any reference to C&E risks or remain at a high-level and non-operational stage, without measurable KPIs/KRIs or direct linkage to variable remuneration. Even where ESG is referenced, it is typically not embedded into performance evaluation frameworks, nor cascaded across different seniority levels. In several cases, banks dismiss the relevance of ESG-linked remuneration due to their business model, which is not aligned with EBA expectations. Overall, frameworks lack clear targets, monitoring mechanisms, and behavioural incentives, limiting their effectiveness in driving C&E risk integration.

Banks are expected to fully integrate C&E considerations into remuneration policies, ensuring a clear and measurable link to strategy, KPIs and KRIs. ESG-related indicators should be well-defined, quantifiable, and cascaded across all relevant levels, and directly tied to variable remuneration and performance. Frameworks should be subject to regular review, supported by monitoring systems, and aligned with sustainability objectives to promote behavioural change and accountability across the institution.

3.3.5 C&E Risk Consideration in the Risk Appetite Statement (including definition of KPIs and KRIs) (GOV. 5)

A few banks have started to integrate C&E considerations into their RAS, through the introduction of initial KPIs/KRIs and early-warning indicators, including metrics linked to physical risks or portfolio segmentation. In some cases, institutions have plans to incorporate dedicated C&E KRIs with defined thresholds and links to concentration metrics and regulatory ratios, as well as align these with the Three Lines Model. These initiatives represent a foundational step towards embedding C&E risks into risk appetite, strategy, and portfolio decision-making.

On the other hand, most institutions demonstrate significant shortcomings in the integration of C&E risks into the RAS. KPIs and KRIs are often irrelevant or not risk-based and sometimes focusing on non-prudential metrics or creating potential greenwashing risks due to lack of clear definitions and linkage to taxonomies. Several banks do not include any reference to C&E risks, indicating weak Board oversight and limited strategic alignment. Even where metrics exist, they typically lack granularity, forward-looking elements, defined thresholds, and coverage across key portfolios, and are not effectively linked to risk management or decision-making processes.

The Authority expects banks to fully embed C&E risks within the RAS by defining relevant, risk-based KPIs and KRIs covering both physical and transition risks, supported by forward-looking methodologies and reliable data. Institutions should establish clear thresholds, limits, and escalation triggers, complemented by early warning indicators to detect emerging risks. These metrics should be aligned with the bank's risk profile, strategy, and capital planning, cascaded across material exposures, and integrated within the Three Lines Model to ensure effective monitoring, timely escalation, and informed decision-making.

3.4 Risk Management Framework

This module refers to the set of policies, tools and methodologies through which an institution identifies, measures, monitors and mitigates C&E risks across all material risk categories. As Figure 4 indicates, LSIs have been proactively considering these risks in scenario analysis and stress testing, however Risk Registers remain underdeveloped and mitigation measures rely primarily on insurance.

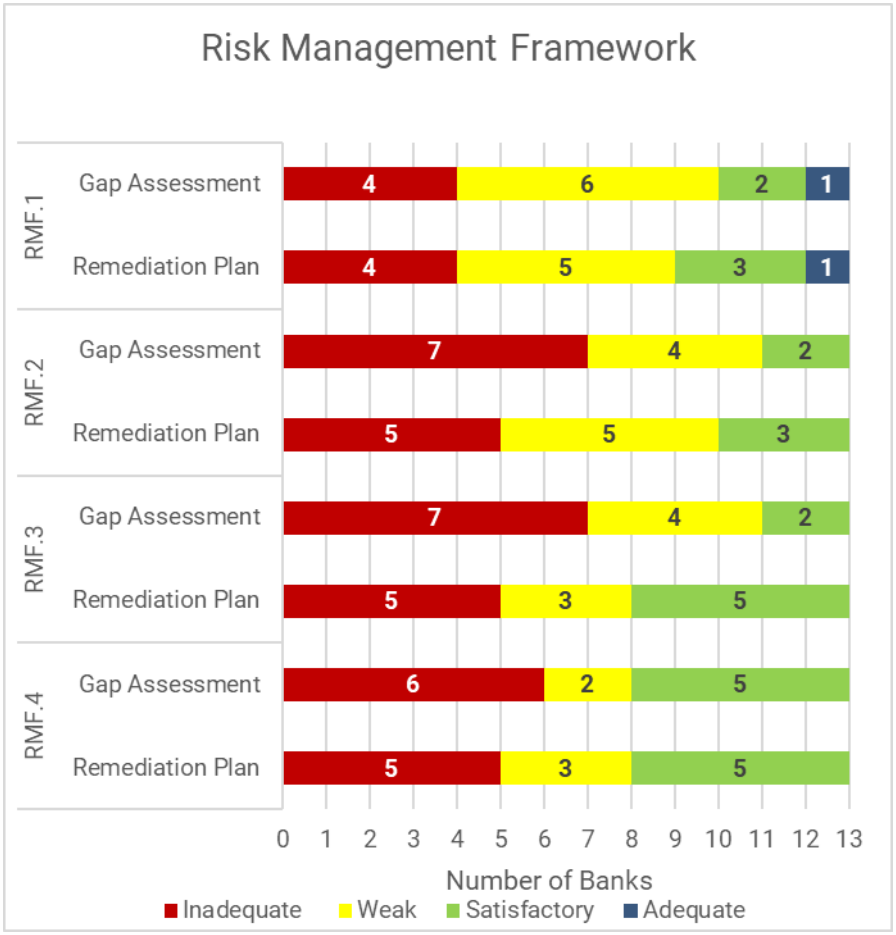


Figure 4. Risk Management Framework

Module: Risk Management Framework	
RMF.1	Incorporation of C&E Risks into the Risk Management Framework
RMF.2	Risk quantification and definition of a Risk Register
RMF.3	Mitigation measures
RMF.4	Incorporation of Risks within the Bank's Capital Plans

Table 4 – Risk Management Framework

3.4.1 Incorporation of C&E Risks into the Risk Management Framework (RMF. 1)

Some institutions demonstrate meaningful progress in incorporating C&E risks into their Risk Management Frameworks, including integration into ICAAP/ILAAP processes.

The Authority observed examples of more advanced practices across a limited number of institutions, due to the depth of their integration of C&E risks into the overall framework. In particular, such banks have effectively incorporated materiality assessment outcomes and climate-related considerations into their ICAAP, supported by the development of stress testing scenarios assessing disorderly transition risks and their impact on the business model. Furthermore, the establishment of a standalone C&E Risk Management Framework, with responsibilities clearly assigned across the

organisation in line with the Three Lines Model, demonstrates a high level of governance maturity. This is complemented by the integration of C&E risks into the Credit Risk Policy and Business Continuity Management framework, including the identification of physical risk scenarios affecting critical operations. Taken together, these elements represent advanced and holistic implementation, illustrating a more advanced stage of implementation.

Despite these efforts, full integration of C&E risks into RMFs remains incomplete across other institutions. In most cases, frameworks remain fragmented, high-level, or descriptive, with limited embedding into policies, tools, governance structures, and internal reporting. Integration across key areas such as stress testing, capital planning, and risk appetite is often partial or missing, and initiatives remain at an early or pilot stage. Remediation plans frequently lack clear timelines, ownership, and implementation detail, while risk registers and dashboards are not sufficiently aligned with long-term resilience objectives.

The Authority expects banks to fully embed C&E risks into their RMFs through a holistic and end-to-end approach, covering identification, assessment, monitoring, management, and mitigation of risks. This includes integration into ICAAP/ILAAP, credit risk processes, stress testing, capital planning, and strategic decision-making, supported by robust data, tools, and internal reporting. Institutions should ensure clear governance, defined responsibilities, and alignment with the Three Lines Model, as well as forward-looking assessments and materiality-driven capital considerations, in line with EBA Guidelines.

3.4.2 Risk Quantification and Definition of a Risk Register (RMF. 2)

A few LSIs have made progress in developing C&E risk identification and quantification approaches, including the use of materiality assessments, initial scenario analysis, and the mapping of physical and transition risk drivers. A few banks have begun integrating these risks into elements of their RMFs, ICAAP, and operational risk registers, supported by the use of scientific tools and portfolio-level exposure analysis. Plans to expand scenario analysis, enhance KRIs, and update risk registers indicate growing awareness of the need for a structured, data-driven, and forward-looking approach.

However, risk quantification and risk register frameworks remain underdeveloped across most institutions. Risk registers are often incomplete, qualitative, or not formally updated to include C&E risks, with limited linkage to exposures, prudential risk categories, or transmission channels. The absence of measurable KPIs/KRIs, defined thresholds, and ownership represents a key supervisory gap. Frameworks frequently lack forward-looking capacity, fail to capture second-order effects, and remain disconnected from data-driven analysis. Remediation plans tend to be high-level and lack clarity on methodologies, governance, and timelines, limiting their effectiveness.

The Authority expects banks to establish a comprehensive, structured, and forward-looking C&E Risk Register as a core risk management tool. This should include a complete inventory of physical and transition risk drivers, clear mapping to prudential risk categories, defined likelihood and impact assessments, and quantifiable KPIs/KRIs supported by data (including proxies where needed). The Risk Register should function as a living document, with assigned ownership, regular updates, defined escalation thresholds, and integration into ICAAP, business continuity planning, and strategic decision-making, ensuring alignment with EBA expectations on risk quantification, data quality, and governance.

3.4.3 Mitigation Measures (RMF. 3)

Mitigation frameworks remain underdeveloped across most institutions. Measures are often narrow in scope, focusing primarily on CO_2 exposure or concentration limits, while neglecting broader risks such as biodiversity, liability risk, and second-order impacts to clients and the broader economy they serve. Many banks either lack formal mitigation measures altogether or rely excessively on insurance as the primary tool, which is not considered sustainable in the long run. Furthermore, mitigation strategies are frequently not embedded in ICAAP, capital planning, or risk management frameworks, lack clear metrics and monitoring mechanisms, and are not supported by robust stress testing or forward-looking analysis.

Nonetheless, some LSIs demonstrate initial progress in developing C&E risk mitigation measures, including integrating elements into lending policies, business continuity frameworks, and stress testing exercises. Positive practices include client engagement initiatives, incorporation of ESG criteria in underwriting (e.g. EPC thresholds), exclusion lists, and early warning indicators, as well as efforts to link mitigation actions to governance and Board oversight. A limited number of banks have adopted a more diversified approach, combining portfolio measures, policy adjustments, and internal controls rather than relying solely on risk transfer mechanisms.

The Authority expects banks to adopt a proactive, diversified, and forward-looking mitigation framework that goes beyond insurance-based solutions. This includes defining concrete actions to reduce exposure to high-risk sectors and geographies, integrating C&E considerations into lending, pricing, and collateral valuation, and engaging with clients on transition plans and risk mitigation strategies. Mitigation measures should be linked to capital planning, stress testing, and risk appetite, supported by clear KPIs/KRIs, and embedded across all business lines and time horizons to ensure effective and sustainable risk management in line with EBA Guidelines.

3.4.4 Incorporation of Risks within the Bank's Capital Plans (RMF. 4)

Some institutions demonstrate clear progress in incorporating C&E risks into capital planning frameworks, particularly through integration into ICAAP/ILAAP processes, stress testing, and scenario analysis. Positive developments include the allocation of capital to identified exposures, the use of portfolio-level assessments supported by external data providers, and the introduction of dedicated dashboards to monitor climate-related KPIs. In more advanced cases, banks have started to assess impacts across multiple risk categories and business lines, reflecting a more structured and forward-looking approach to capital adequacy and resilience.

However, significant gaps remain across most institutions. Capital planning is often narrowly focused on transition risks (e.g. CO_2), with limited consideration of physical risks, broader environmental drivers, or long-term /horizons. In many cases, there is no quantification of capital impact or dedicated capital allocation, and scenario analysis remains partial, underdeveloped, or absent. Frameworks frequently lack integration with risk appetite, governance, and internal reporting, including the absence of consolidated dashboards. Some banks have not yet incorporated C&E risks into their ICAAP at all, while remediation plans often lack clear methodologies, timelines, and strategic alignment, limiting their effectiveness.

The Authority expects banks to fully integrate C&E risks into their capital planning frameworks through forward-looking, scenario-based ICAAP processes. Institutions should assess the impact of both physical and transition risks across short-, medium-, and long-term horizons, quantify potential effects on capital adequacy, and define appropriate capital buffers and management actions. This requires robust stress testing methodologies, clear linkage to risk appetite and strategy, and the use of structured reporting tools (e.g. C&E dashboards) to enhance transparency and oversight. Banks

must ensure that capital planning remains dynamic, data-driven, and aligned with evolving risk profiles, in line with EBA expectations.

4.0 Closing Remarks

The Authority acknowledges the progress made by Maltese LSIs in strengthening their approaches to the identification, assessment, monitoring, and management of C&E risks. The assessment demonstrates that awareness and engagement have increased considerably since the 2023/24 Thematic Review, with institutions enhancing governance arrangements, strengthening Board oversight, developing materiality assessment methodologies, and beginning to integrate C&E considerations into risk management, capital planning, and strategic decision-making processes.

Notwithstanding these positive developments, the review also highlights that implementation remains uneven across the sector and, in many cases, is still at an early stage of maturity. While institutions have generally established foundations for managing C&E risks, significant work remains to translate high-level frameworks, gap analyses, and remediation plans into fully operational, measurable, and forward-looking practices. In particular, further efforts are required to strengthen data capabilities, develop meaningful metrics and materiality thresholds, enhance scenario analysis and stress testing methodologies, improve risk quantification practices, and embed C&E considerations more consistently within governance, risk appetite, and capital planning frameworks.

As C&E risks continue to evolve, institutions should recognise that these risks are not merely a regulatory consideration but an increasingly important component of prudent risk management and long-term business resilience. Climate change, environmental degradation, and the transition to a more sustainable economy have the potential to affect institutions through a wide range of transmission channels, influencing asset quality, profitability, operational resilience, funding conditions, and strategic positioning over both the short and longer term. Effective management of these risks therefore requires a comprehensive institution-wide approach that is proportionate to the nature, scale, and complexity of each institution's activities.

The Authority expects Boards and Senior Management to continue driving the integration of C&E risks across their institutions, ensuring that governance arrangements, business strategies, risk management frameworks, and capital planning processes remain aligned with the evolving risk landscape. Institutions should also seek to leverage developments in data availability, analytical capabilities, and scenario analysis techniques to strengthen their understanding of emerging vulnerabilities and opportunities, thereby improving strategic decision-making and enhancing resilience over time.

The MFSA will continue to monitor progress through its ongoing supervisory engagement and assessments. C&E risks will increasingly form part of supervisory evaluations, including the Supervisory Review and Evaluation Process (SREP), and will be considered in the assessment of governance arrangements, risk management frameworks, business model sustainability and capital adequacy. Institutions are therefore expected to maintain momentum and continue progressing towards robust, data-driven, and forward-looking approaches that are consistent with applicable regulatory requirements and supervisory expectations.

Ultimately, the effective management of C&E risks should be viewed as an investment in the long-term resilience, sustainability, and competitiveness of institutions. Those institutions that successfully embed these considerations into their decision-making frameworks will be better positioned to navigate evolving risks, support their customers and communities through the transition

to a more sustainable economy, and maintain the resilience of their business models in an increasingly complex operating environment.

Yours sincerely,
Malta Financial Services Authority

Christopher P. Buttigieg
Digitally signed by Christopher P. Buttigieg
Date: 2026.11.16 09:04:37 +01'00'

Catherine GALEA (Signature)
Digitally signed by Catherine GALEA (Signature)
Date: 2026.11.16 09:39:23 +01'00'

Christopher P. Buttigieg
Chief Officer Supervision

Catherine Galea
Head - Banking Supervision

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