10th September 2024

Conduct Supervision
Tel: (+356) 21441155

By e-mail

Dear Chief Executive Officer
Dear Compliance Officer

Re: Green / Sustainable Products Thematic Review

You are receiving this letter as a Chief Executive Officer and Compliance Officer of a Credit Institution supervised by the Malta Financial Services Authority (referred to herein as the "MFSA" or the "Authority").

Background

The MFSA endeavours to stimulate compliance with applicable rules governing Credit Institutions for a fair, honest, and transparent financial market, which in turn strengthens confidence within the same market, with the ultimate aim of protecting retail clients. In order to achieve this, the Authority uses a variety of tools, including investigations, off-site work, on-site inspections, and thematic reviews, to carry out its supervisory activities within the supervised Licence Holders. The ultimate goal is for the Licence Holders to achieve high compliance standards while being more Client focused rather than Product focused when manufacturing and distributing their products and services.

Within the EU policy framework, sustainable finance relates to the channelling of funds towards economic expansion which mitigates environmental stressors in order to contribute to the achievement of the climatic and environmental goals of the European Green Deal, taking social and governance considerations into account.

In addition to spearheading efforts to create a financial system that fosters sustainable growth, the European Union firmly supports the shift to a low-carbon, more resource-efficient, and sustainable economy.

In light of this, several Credit Institutions have issued a variety of retail products with the aim of channelling funds towards economic activity having more positive ESG goals. Such credit products are more commonly referred to as Green Loans, which are a form of a credit facility that supports and finances environmentally friendly projects and initiatives for personal use. Additionally, Green Deposits have also been launched in recent years. This type of deposits allows customers to satisfy their sustainability goals and objectives while receiving a return on their non-working capital/excess liquidity. Green Loans and Green Deposits are frequently referred to collectively as "Green Products".

There is evidence that there are instances when certain products marketed/labelled as "Green" are not actually "Green". This is the case not just for banking products. It could be the case that this is not done maliciously, but it is possible that manufacturers are unsure of the proper criteria for classifying a product as "Green". This is known as Greenwashing. The consequence of Greenwashing is that consumers may be misled in purchasing products which, despite their nomenclature, would not meet their environmental aspirations and ambitions.

It is important for Credit Institutions to address the risk of Greenwashing when manufacturing its products since this could lead to serious reputational and legal risks, damaging both the Institutions themselves and their clients' objectives. Additionally, this hinders the growth of the sustainable financial markets and products, which would eventually slow down the transition to a carbon-neutral economy.

During the first half of this year, the Banking Team within the MFSA's Conduct Supervision Function has carried out a Thematic Review ("the Exercise") to assess the Green/Sustainable products offered by local Credit Institutions to **retail clients**. The focus of this exercise was to assess whether the promotional material and the information provided to clients match the product's actual sustainable features, in order to eliminate the possibility of Greenwashing.

This letter sets out MFSA's main findings related to the said Thematic Review, as well as the Authority's supervisory expectations from the Credit Institutions with respect to this particular topic, whilst also providing an insight and guidance together with good practices which the Authority expects to be adopted by Credit Institutions providing Green products.

Methodology

The products in scope for this Thematic Review were Green/Sustainable Banking products, such as Green Loans and Green Deposits. Given that such Green/Sustainable Products are not yet so widespread in the local market, a data collection exercise with all the Green/Sustainable Products offered to local retail clients from every Credit Institution forming part of this Thematic Review was launched. Prior to embarking on the Thematic Review, the Authority analysed websites of Credit Institutions who offer their services to local retail clients, to determine which Credit Institutions do actually offer Green Products. This was necessary in order to decide on the sample required for this exercise.

As a result of this exercise, 6 Credit Institutions were selected given that they were the only ones offering Green Products to the local retail market.

Each selected Credit Institution was required to provide a detailed inventory of all the Green/Sustainable Products that are presently offered to the local retail customers, along with information on the attributes of each product that was available between 2022 and 2023.

A list of already drawn-down Green Loans for 2023, with their respective Tariff of Charges, internal policies and handbooks, and any other information pertaining to such products were also requested. The Authority additionally asked for a list of any discontinued Green Products. This was necessary to have a holistic overview of the Green/Sustainable Products currently on offer by the respective Credit Institutions. Any amendments or enhancements to the existing products had to be highlighted by the Credit Institutions which were part of this thematic review, and the Authority also requested such entities to provide an insight of any new "Green" Products which they have in the pipeline. Additionally, the documents relating to product oversight and governance, together with the product approval process were analysed accordingly.

Out of the fourteen banking products presented to the Authority further to the above requests, four have been discontinued. The remaining ten products were analysed accordingly. When deemed necessary, the Authority requested additional information through a series of online meetings or email correspondence with the Credit Institutions concerned. During the Authority's interactions, guidance was provided to the licensed institutions and the Authority's expectations were also discussed.

Further to this review, the Authority identified several shortcomings and requested Licence Holders to update their processes or documents accordingly. Finally, a personalised follow-up letter was then sent to all the Credit Institutions forming part of this Thematic Review. This Review is in line with the Supervisory Priorities for MFSA's Conduct Supervision Function for 2024.

The following parts of this letter are divided into three sections. Section A refers to the general market observations that emanated from the review together with MFSA's Expectations, Section B highlights the good practices identified by the Authority during the Thematic Review while Section C refers to the EBA Report about Greenwashing and the Authority's expectations following this Thematic Review.

Section A. General Market Observations and MFSA Expectations

Green/Sustainable Loans

a) Pre-Contractual Documentation

i. Findings re Fees:

Upon reviewing the Tariff of Charges submitted by the Institutions subject to this review, the Authority noted that certain fee waivers that are applicable to such products were not featuring in the above-mentioned document. However, during the follow up meetings, the Credit Institutions did indicate that this kind of fee waiver is disclosed to the client during the in-person meetings.

(+356) 2144 1155
info@mfsa.mt
www.mfsa.mt

Malta Financial Services Authority
Triq l-Imdina, Zone 1
Central Business District, Birkirkara, CBD 1010, Malta

Expectations

In this regard, the Credit Institutions are expected to disclose such fee waiver in the Tariff of Charges, for the clients' benefit and for these to be able to compare offers prior to selecting a product. This is especially necessary in the context of the move towards greater digitalization where information is expected to be readily and easily accessible in digital format on the Credit Institution's website.

ii. Findings: Inputting errors

The Authority acknowledges that such Green/Sustainable Loans generally have lower interest rates than traditional loans. The Authority observed that occasionally, because of program/system limitations, an incorrect base rate and/or spread were quoted in the Sanction Letter.

Expectations

Credit Institutions are expected to quote the right information in the Credit Agreement for the client to have clear information regarding the terms and conditions of the loan. As per the Mortgage Credit Regulations, Regulation 7(3), the ESIS, and draft Credit Agreement are to reflect the same information throughout, without any discrepancies.

iii. Findings: Misleading information due to system limitations

Credit Institutions are expected to ensure that the contents of the Credit Agreement and that of the pre-contractual documentation, (such as SECCI or ESIS as may be applicable), always quote the correct Base Rate/Spread. Furthermore, it is imperative that the Credit Institution's systems can cater for any negative spreads offered on the Bank's base rate by the Credit Institution prior to launching the product.

Expectations

Credit Institutions are expected to carry out testing on their systems to identify such mishaps before launching the product and in the case of any future changes to the Bank's base rate.

iv. Findings: Green Home Loans

When it comes to Green Home Loans, the Authority noted that clients may present the Energy Performance Certificate (EPC) on the contract date itself or just a few days earlier. In anticipation to this, it was noted that certain Credit Institutions provide the clients with an ESIS and a Credit Agreement quoting the normal home loan rate, while including a clause within the same documents mentioned earlier that if the EPC provided is below a certain reading, a discount on the interest rate will be applicable.

Expectations

Presenting information to clients in this manner is considered by the Authority as incomplete and could become confusing for the client to compare offers available in the market. A good EPC certificate will trigger a reduction in interest, hence a reduction in monthly repayments, together with a lower total interest payable and a lower APR.

In this regard, the Authority would expect that Credit Institutions should provide two sets of amortization tables with the ESIS; one reflecting the features of a normal Home Loan and one reflecting those of a Green Home Loan. These should include a clear illustration of the interest rate, APRC, and repayment schedule for both scenarios.

When it comes to the Credit Agreement provided by the Credit Institutions, it is expected to either:

- refer to both loan options together with their respective features including rate of interest, total interest payable, together with monthly repayments and APR;

or

- issue an amendment letter/superseding agreement to the original credit agreement when it is confirmed that the approved loan is classified as a Green Home Loan.

v. Findings: Disbursement of Funds against Evidence

After examining the process leading to the disbursement of the funds by the Credit Institution to the client, it was noted that:

- The Credit Institutions frequently failed to collect from clients the appropriate documents as per their own policies and procedures. There were several instances where the Credit Institutions were not able to provide a copy of the invoice or order form that the client had to submit prior to the loan drawdown as per the credit institution's own policy.
- Regarding second-hand products, where product order forms or invoices are not available or possible to provide, the Credit Institutions were unable to produce any type of supporting documentation proving that the funds were allocated to the purchase of a Green Product.
- From the Green Loan proposal forms provided to the Authority, it was noted that sometimes the Credit Institutions were not properly documenting the reasons and supporting information that were considered for the final loan decision. This was mostly particular for further discounts granted over and above the Green Product's standard rate.

Expectations

- Credit Institutions are to ensure that proof of intention is always provided by the clients prior to the loan drawdown. This would mitigate the risk of clients using the funds for non-Green Projects and not as disclosed in the Loan application.
- Credit Institutions are expected to train and constantly remind their employees to obtain the right documentation that proves the product's Green status prior to the loan drawdown in order to issue the funds. The Authority strongly recommends that the four-eye principal is applied to mitigate such risks before the drawdown is effected.
- Credit Institutions are expected to clearly document all the information and reasoning that led to the final approval of the Green Loan proposals. Having such information compiled on file provides a more cohesive analysis for external assessors/auditors to draw up conclusions. The Credit Institution's official authorising the loan would also have clear justification for his/her recommendation for approval.

Section B. Good Market Practices Identified

- 'Market Demand for Green Products' – Credit Institutions are conscious of this increasing trend and higher demand for such Green Products (both credit and deposit products). The Credit Institutions that were part of this exercise have a good range of Green Products available and some do have further products planned in their pipelines for the near future. The Authority appreciates such initiative and uptake, while it encourages its Licence Holders to continue to explore more opportunities to offer such products in the market.

- 'Enhancement of Green Products' – The Authority observed that Credit Institutions have improved these products along the years to meet client demands and expectations. Such an endeavour suggests that Credit Institutions are prepared and willing to follow and keep up with emerging market trends in order to accommodate their clients' needs towards a more sustainable environment.

- 'Advantageous Interest Rate' – During this exercise it was clearly noted that Green Loans are offered with a lower interest rate than the "normal loans", while Green Term Deposits are offered with a higher interest rate than "normal deposits". Such initiatives are in place to encourage clients to opt for such products in the market while accelerating the take-up for such Green Products.

- Product Oversight and Governance (POG) –It was noted that the majority of the Credit Institutions generally follow EBA's Guidelines on POG, when manufacturing their Green Products. The Authority also noted that Credit Institutions manufacture and distribute their own products without reliance on other providers.

Section C. EBA Report on Greenwashing and MFSA Expectations

The European Commission has requested information from European Supervisory Authorities (ESAs) on the issue of "Greenwashing" and requested a progress report by May 2023 and final report by May 2024, along with policy recommendations, within their sectoral remit and competencies.

The ESAs were tasked with advising on:

- Common Greenwashing understanding;
- Types;
- Complaints;
- Risks to entities within the financial services sector;
- Investors and consumers;
- Supervisory practices;
- Monitoring tools; and
- Gaps in the current legislative framework.

The EBA's Final Report (EBA/REP/2024/09) addresses the European Commission's concerns on Greenwashing by building on the Progress Report's findings (EBA/REP/2023/16). It reinforces the high-level understanding and provides recommendations to Institutions, Supervisors, and Policymakers, enhancing the understanding of Greenwashing among the three ESAs.

The Final Report (EBA/REP/2024/09) highlights the following:

- A common high-level understanding on Greenwashing with key features;
- The most relevant types of Greenwashing, its occurrences and complaints related to it;
- The risks that Greenwashing poses to financial sector entities, investors and consumers;
- The supervisory practices, experiences, and capacities, including tools to monitor Greenwashing; and
- The gaps, inconsistencies, and problems in the current legislative framework.

The Progress Report, preceding the above-mentioned Final Report published in May 2023 was more of a stock-take exercise in order to better understand the situation at that particular point in time. It provided initial findings and proposed a common high-level understanding of Greenwashing by the three ESAs. The Final Report reiterates the common high-level understanding and delves into further detail. It also provides recommendations to Credit Institutions, Supervisors, and Policymakers on how to avoid Greenwashing.

In relation to preventing and mitigating the risks of Greenwashing, the EU sustainable finance regulatory framework provides valuable insight to prevent, identify and mitigate aspects of Greenwashing. Such a framework particularly provides insight on how to better identify

Greenwashing activities, improve the disclosure framework, and harmonise criteria while providing valuable guidelines in relation to the labelling for certain Green Financial Products.

The EBA appreciates the trends towards stronger sustainability reporting and emphasises that disclosure obligations assist the policy goal of reducing Greenwashing. Transparency and metrics for sustainable and climate-related information can help stakeholders assess the sustainability of a financial product or entity, hence reducing the risk of Greenwashing.

In the Final Report, the EBA lists several market practices on how stakeholders should mitigate Greenwashing issues. These methods provide a non-mandatory, illustrative aim by supporting Credit Institutions in developing effective techniques and strong mechanisms to combat Greenwashing.

Credit Institutions are expected to reflect upon and identify a number of strategies to reduce and mitigate the risk of Greenwashing at the product and/or service level. These strategies include implementing existing guidelines and/or standards, creating appropriate procedures and controls to manage their environmentally friendly and sustainable products, and being transparent about a clear list of projects and activities that qualify for such financing.

In relation to product governance, Credit Institutions are expected to use fundamental ideas and procedures to guarantee that sustainability-related statements regarding goods and services are adequate, understandable, and consistent. This entails disseminating accurate and balanced information on the methodology, statistics, and important sustainability aspects of the product throughout the commercialisation process. Greenwashing risk may be reduced and mitigated by modifying the product approval procedures and regulations for sustainable and Green Financial Products. This will ensure that the sustainable features of such products meet the objectives and characteristics of their target markets, without "window dressing" the products' features in order to make them look like Green Products but without actually meeting the necessary criteria for such products to be labelled as Green.

Robust internal processes and policies for goods and services with sustainable characteristics may cut down on any possible interpretation space and lessen the chance of Greenwashing. Credit Institutions should either be open about the various criteria and definitions they employ, or they should utilise definitions and criteria based on international and European standards, such as the European Green Bond Standard (EuGB). This strategy can lessen the possibility of misleading investors, consumers, or savers in their product approval processes and policies.

Credit Institutions are advised to use market guidelines or industry best practices to reduce the risk of Greenwashing at the product level. Guidelines for Green, Social, Sustainable, and Sustainability-linked Loans have been developed to assist in product design, definitions, criteria, and selection of Key Performance Indicators (KPI) and Sustainability Performance Targets (SPT). Credit Institutions providing such loans should address Greenwashing risk to protect their credibility and reputation. Credit Institutions should scrutinise their interactions with borrowers and the creation of their products thoroughly. Factors such as the ambition

(+356) 2144 1155
info@mfsa.mt
www.mfsa.mt

Malta Financial Services Authority
Triq l-Imdina, Zone 1
Central Business District, Birkirkara, CBD 1010, Malta

and substance of KPIs and SPTs can contribute to reducing the risk of Greenwashing. On the other hand, transparency in relation to documentation presented to clients and genuine product features contribute to a more sustainable economy while mitigating the risks of Greenwashing which can eventually harm the confidence in the market.

Credit Institutions promoting environmentally friendly savings or deposit accounts are expected to implement measures to ensure adherence to these values. This includes creating a precise structure for allocating funds from Green Deposits to environmental sustainability initiatives. Additionally, Credit Institutions should provide deposit holders with detailed information on fund allocation to ensure transparency.

Credit Institutions are encouraged to view the Full Final EBA Report in order to get a comprehensive idea of the report.

Way Forward

The MFSA will be continuously monitoring such Green Products along others and actively encourages the provision and uptake of such products. In the meantime, Credit Institutions offering Green Products are expected to conduct a gap analysis and update their processes and procedures in order to come in line with the Expectations as noted in this Letter.

Should you require any clarification on the above, please do not hesitate to contact the Authority's Conduct Supervision Function on conductbanking@mfsa.mt.

Yours Sincerely
Malta Financial Services Authority

Christopher Peter BUTTIGIEG (Signature) Digitally signed by Christopher Peter BUTTIGIEG (Signature) Date: 2024.09.10 17:56:11 +02'00'

Dr. Christopher P. Buttigieg
Chief Officer – Supervision

Sarah PULIS (Signature) Digitally signed by Sarah PULIS (Signature) Date: 2024.09.10 17:47:43 +02'00'

Dr. Sarah Pulis
Head Conduct Supervision

(+356) 2144 1155
info@mfsa.mt
www.mfsa.mt

Malta Financial Services Authority
Triq l-Imdina, Zone 1
Central Business District, Birkirkara, CBD 1010, Malta