“BEYOND PROFITS:WHY BANKS ARE BETTING BIG ON ESG RISK ANAGEMENT”

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Abstract. *ESG risks are a new challenge for the banking sector. The article discusses tools to minimize them: from integration into the credit process to adaptation to international standards. The emphasis is on practical steps: employee training, transparent reporting and “green” products. The experience of the EU and Uzbekistan shows that ignoring ESG leads to loss of investors and fines.*

Key words: *ESG, impact of climate, environmental factors, social factors, management factors,*

Аннотация. *ESG-риски — новый вызов для банковского сектора. В статье разобраны инструменты их минимизации: от интеграции в кредитный процесс до адаптации под международные стандарты. Акцент на практических шагах: обучение сотрудников, прозрачная отчетность и «зеленые» продукты. Опыт ЕС и Узбекистана показывает: игнорирование ESG ведет к потере инвесторов и штрафам.*

Ключевые слова: *ESG, влияние климата, экологические факторы, социальные факторы, факторы управления*

Annotatsiya*. ESG risklari bank sektori uchun yangi muammodir. Maqolada ularni minimallashtirish vositalari ko'rib chiqiladi: kredit jarayoniga integratsiyadan tortib xalqaro standartlarga moslashishgacha. Amaliy qadamlarga e'tibor: xodimlarni o'qitish, shaffof hisobot va yashil mahsulotlar. Yevropa Ittifoqi va O‘zbekiston tajribasi shuni ko‘rsatadiki, ESGga e’tibor bermaslik investorlarning yo‘qolishiga va jarimaga olib keladi.*

Kalit so'zlar: *ESG, iqlimning ta'siri, atrof-muhit omillari, ijtimoiy omillar, boshqaruv omillari*

«For most of history, man has had to fight nature to survive; in this century he is beginning to realize that, in order to survive, he must protect it»

Jacques-Yves Cousteau (1910-1997) - a French naval officer, ocean explorer

The abbreviation ESG can be deciphered as “ecology, social policy and corporate governance”. In a broad sense, it is the sustainable development of commercial activities, which is based on the following principles [1]:

- responsible attitude to the environment (E - environment);
- high social responsibility (S - social);
- high quality of corporate governance (G - governance).

Between 2015 and 2019, the largest European banks came to realize the significance of ESG risks and started to develop mechanisms to control them. Therefore, environmental, social

policy and corporate governance factors were included in their risk management strategies and rules, as well as in their risk appetites. Principles for measuring ESG risk in the internal capital assessment process and limits on ESG risks have also been developed [2]. These principles are still not universal and to a large extent may differ from bank to bank.

One of the key factors that have influenced the development of banks' ESG activity has been public concern about climate change. That is why banks are now actively analyzing the possible impact of climate change trends on their business, including in the long term. And climate risks have even started to be singled out as a separate group.

ESG risk assessment questionnaires are widespread in banking practice as part of the credit process. The purpose of such assessment is to identify any sustainability-related risks affecting the financial position of clients. As a result, the bank's ESG risk analysis takes into account ESG factors that may have a significant impact on financial results, client solvency or the value of the client company, as well as the impact of clients' business activity on the bank itself and its ESG factors [1].

The following factors are most commonly used by banks to assess and manage ESG risk:

environmental factors:

- greenhouse gas emissions
- other atmospheric emissions
- water pollution
- energy consumption and efficiency
- water consumption
- Soil pollution and degradation
- deforestation
- natural resource consumption
- waste management
- protection of biodiversity and ecosystems
- development of low carbon and environmental technologies
- regulatory constraints (e.g. carbon tax, etc.)
- risks associated with climate change and extreme weather events
- changes in consumer attitudes and preferences due to growing awareness of environmental issues
- the risk of financial liability for the negative environmental impact of operations

social factors:

- maintaining social cohesion
- respect for diversity
- investment in human capital and staff development
- countering discrimination on any grounds
- combating inequality and promoting equal opportunities
- safe and healthy working environment
- health and safety of clients, society and the environment
- protecting client confidentiality
- respect for human rights (e.g. opposing forced labor, child labor, modern slavery, etc.).

- respect for workers' rights (e.g. right to associate, right to protest, right to collective bargaining, etc.).
- risk of failure to prevent threats of terrorism and cybercrime
- risk of spreading infectious diseases
- risk of financial liability for the negative impact of the activity on society

management factors:

- unfair business practices
- non-compliance with corporate governance standards (including information transparency, ethics policy, etc.).
- gender diversity
- internal audit
- independence of the management board
- salaries of management and executives
- corruption
- respect for shareholder rights
- stakeholder participation
- ESG risk management system efficiency
- supply chain sustainability
- risk of financial losses due to an ineffective corporate governance system

Currently, EU banks are cautious when financing sectors of the economy exposed to ESG risks and limit their portfolios in areas incompatible with the principles of sustainable development. Corporate social responsibility policies and principles are being introduced for such sectors. As a result, in order to become a client and receive financing, companies are required to comply with ESG principles developed specifically for a particular economic sector [3] (they are still not unified and may differ from bank to bank).

It goes so far that a bank may decide to terminate services to a current client if it systematically commits serious violations of ESG principles in its activities.

At the same time, these factors are taken into account only by the leading EU banks, but they are not widespread in our region. The concept of ESG risks is still a fashionable trend rather than a widespread term.

In recent years, the global trend towards ESG-transformation has actively affected Uzbekistan. A particularly prominent role in this process is played by banks with foreign participation, which since 2022 have begun to take active steps to integrate the principles of sustainable development into their activities. This testifies not only to the growing maturity of the Uzbek ESG market, but also to the serious concern of private business about the sustainable development of the country's economy and social sphere.

Today, non-financial reporting (ESG reporting) has become as important a disclosure tool as traditional financial reporting. In Europe, in accordance with the EU Non-Financial Reporting Directive, about 11,000 companies already publish such data, and in the coming years their number will grow to 50,000. In Russia, more than 100 large corporations regularly report on their ESG indicators[2].

In Uzbekistan, this process is still at the initial stage, but the dynamics are evident. Banks with foreign capital were the first to introduce ESG principles (e.g. “Uzpromstroybank” with the

participation of EBRD, “Alokabank”, “Khamkorbank”) [5][6]. They develop “green” loan products and take ESG risks into account when financing projects.

Uzbekistan demonstrates a growing interest in sustainable development, and in the coming years it is expected to

- increase the number of companies publishing ESG reporting;
- develop “green” financing, including issuance of sovereign ESG-bonds;
- strengthen the role of international institutions (EBRD, IFC) in supporting ESG-transformation of Uzbek business.

Thus, although Uzbekistan is still lagging behind Europe and Russia in ESG disclosure, the active actions of banks and corporations point to the rapid development of this area in the country.

Sustainability reporting provides companies with a number of benefits:

- Improved reputation and image. Sustainability reporting allows companies to demonstrate their commitment to ESG principles. This helps improve a company's reputation with customers, investors, regulators and the public.

- Attracting investment. Investors are increasingly looking at ESG metrics when making investment decisions. Sustainability reporting provides an opportunity for companies to disclose their ESG practices, to attract investors interested in responsible investing.

Banks that ignore ESG risks face not only reputational losses but also financial threats - from investor exodus to fines. In contrast, institutions that actively implement sustainable practices (like BNP Paribas or Hamkorbank) gain access to green finance and long-term customer trust.

Recommendations:

Establish interdisciplinary ESG committees with risk managers and environmentalists.

Invest in AI-tools for climate risk forecasting.

Develop partnerships with IFIs (EBRD, IFC) to adapt best practices.

“ESG risk management is not a cost, but an investment in the future stability of the bank.” Those who realize this early will be the winners.

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