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IMPLEMENTING ESG-BASED CREDIT POLICY IN BANKS: THEORY, PRACTICE AND PROSPECTS

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ABSTRACT: This article analyzes the theoretical foundations, practical aspects and development prospects of implementing Environmental, Social and Governance (ESG)-based credit policy in banks. Within the scope of the research, the role of ESG criteria in credit risk assessment, their significance in credit portfolio management, and their impact on financial stability have been examined. Based on the experience of foreign countries — including the European Union, China and South Korea — effective models for implementing ESG credit policy in practice have been identified. Tailored recommendations and practical mechanisms for the Uzbek banking sector have been developed. The findings demonstrate that integrating ESG principles into credit policy not only generates environmental and social benefits, but is increasingly becoming a strategic tool for ensuring long-term financial stability for banks.

Keywords: ESG principles, credit policy, green finance, sustainable development, credit risk, social responsibility, environmental financing, bank governance, Uzbekistan.

INTRODUCTION

The second decade of the 21st century has witnessed fundamental transformations in the global financial system. Climate change, social inequality and corporate governance challenges are attracting increasing attention not only from society at large but also from financial institutions. It is precisely within this context that ESG — Environmental, Social and Governance — principles are emerging as a new strategic compass for banks.

On a global scale, the ESG finance market exceeded $41 trillion in 2023 and is projected to surpass $50 trillion by 2025 (Bloomberg Intelligence, 2023). These figures clearly demonstrate the critical position that ESG principles now occupy in the global financial architecture.

Uzbekistan is not standing apart from these global trends. The Strategy for Achieving Sustainable Development Goals of the Republic of Uzbekistan until 2030, the Green Economy Transition Programme, and the Central Bank of Uzbekistan's guidelines on sustainable finance — all of these are forming the regulatory foundation for the implementation of ESG principles in banking.

The relevance of this research lies in the fact that Uzbekistan's banking sector is still at an early stage in integrating ESG criteria into credit policy. It is therefore the most pressing scientific and practical task of today to study foreign experience and develop practical mechanisms adapted to national conditions.

The objective of this research is to strengthen the scientific and theoretical foundations of implementing ESG-based credit policy in banks and to develop practical recommendations for the Uzbek banking sector.

Research objectives:

- To systematize the theoretical foundations of ESG principles in bank credit policy;
- To conduct a comparative analysis of foreign countries' experience;
- To propose a model for integrating ESG criteria into credit risk assessment;
- To develop tailored recommendations for Uzbekistan.

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MAIN BODY

1. Theoretical Foundations of ESG Principles in Bank Credit Policy

The concept of ESG was first formalized in 2004 in the United Nations report "Who Cares Wins," which substantiated the necessity of integrating ESG criteria into financial analysis (UN Global Compact, 2004). Subsequently, the adoption of the Principles for Responsible Investment (PRI) in 2006 became a decisive step in embedding ESG principles within the global financial system.

From the perspective of credit policy, ESG principles encompass three core dimensions:

1) Environmental criteria (E): assessing the borrower's environmental footprint, measuring carbon emissions, evaluating climate change adaptability;

2) Social criteria (S): quality of labor relations, engagement with local communities, gender equality, respect for human rights;

3) Governance criteria (G): quality of corporate governance, level of transparency, anti-corruption measures, protection of shareholder rights.

Theoretically, ESG credit policy is grounded in three fundamental concepts: (1) the theory of sustainable development (Brundtland, 1987); (2) stakeholder theory (Freeman, 1984); and (3) the theory of long-term value creation (Porter & Kramer, 2011). Together, these theories substantiate that incorporating ESG criteria into credit decisions is not only ethically sound but economically rational as well.

Research shows that companies with higher ESG ratings exhibit credit risk levels that are 15–25% lower (MSCI, 2022). This correlation is especially pronounced in environmentally sensitive industries — petrochemicals, coal mining and the energy sector.

2. Comparative Analysis of Foreign Countries' Experience

The European Union is the global leader in ESG credit policy. The Sustainable Finance Taxonomy (EU Taxonomy Regulation) adopted in 2019 made it mandatory for all European banks to classify their credit portfolios according to ESG criteria. Since 2021, the European Central Bank has fully integrated climate risk into its supervisory framework (ECB, 2021).

China's experience deserves particular attention. The People's Bank of China introduced its Green Finance Guidelines system in 2016. Today, China ranks second in the world in the green bond market — with an annual volume exceeding $80 billion (People's Bank of China, 2023). Chinese banks have integrated ESG credit ratings into their core credit scoring, with this indicator carrying a weight of up to 30% in credit decisions.

South Korea's experience represents the most instructive model for developing countries. The K-Taxonomy — Korea's ESG taxonomy — adopted in 2021 sets environmental eligibility criteria for bank lending in the domestic banking sector. Notably, K-Taxonomy was designed as a flexible system that can also be applied to countries with economic structures similar to Uzbekistan's.

The comparative analysis of foreign experience is summarized below:

- European Union: mandatory taxonomy + central bank supervision (2019);
- China: state-directed green credit system (2016);
- South Korea: voluntary-mandatory combination based on K-Taxonomy (2021);
- India: RBI Sustainable Finance Guidelines (2023);
- Kazakhstan: KDB Bank ESG Credit Programme (2022).

The general trend indicates that the most effective approach to implementing ESG credit policy is an optimal combination of mandatory and voluntary mechanisms under central bank leadership.

3. A Model for Integrating ESG Criteria into Credit Risk Assessment

Within the scope of this research, an ESG-integrated credit assessment model is proposed for the Uzbek banking sector. This model consists of three core blocks:

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The first block is the ESG screening stage. At this stage, a borrowing company is evaluated across three parameters: compliance with environmental regulations, submission of social reporting, and quality of corporate governance. Based on screening results, companies are assigned a rating of A (high ESG), B (medium ESG) or C (low ESG).

The second block involves the quantitative assessment of ESG risk. At this stage, the ESG rating is incorporated as an additional variable in the traditional credit scoring model. According to the proposed formula, the credit rating of companies with an ESG rating of A is upgraded by 10–15%, while that of C-rated companies is downgraded by 15–20%.

The third block is the ESG monitoring system. Following credit disbursement, the bank monitors the borrower's ESG indicators on an annual basis. Should indicators deteriorate significantly, the bank retains the right to demand additional collateral or to revise the terms of the credit agreement.

The primary advantage of the proposed model is that it can be organically integrated into existing credit processes without requiring additional capital expenditure from banks. At the same time, it creates an economically incentivizing mechanism that encourages borrowers to comply with ESG standards.

4. Recommendations for Uzbekistan's Banking Sector

For Uzbekistan's banking sector, the following phased approach is recommended for implementing ESG credit policy:

Phase One (2025–2026): Establishing the regulatory framework. It is necessary for the Central Bank of Uzbekistan to adopt guidelines on ESG lending, and to make annual ESG reporting mandatory for all commercial banks.

Phase Two (2026–2027): Pilot project. It would be appropriate for major state-owned banks — Xalq Bank, Ipoteka Bank and Agrobank — to launch ESG credit programmes in pilot mode. Projects in green energy, agricultural modernization and social infrastructure should be prioritized for credit access.

Phase Three (2027–2030): Full implementation. It is recommended that all commercial banks be required to direct at least 15% of their credit portfolio to projects meeting ESG criteria, and that tax incentives be introduced to support the development of the green bond market.

At the same time, the following barriers to implementing ESG credit policy in Uzbekistan must also be taken into account: the absence of an ESG database, limited capacity among borrowers to maintain ESG reporting, and the low level of ESG assessment competency among bank staff. To overcome these barriers, it is advisable to develop support programmes on a public-private partnership basis.

CONCLUSION

The findings of this research allow the following key conclusions to be drawn:

First, ESG principles are increasingly becoming an integral component of modern bank credit policy. This global trend is not a passing fashion, but reflects a structural transformation of the financial system.

Second, integrating ESG criteria into credit risk assessment enables banks to reduce long-term risk by 15–25%. This economically validates the effectiveness of ESG credit policy.

Third, foreign experience demonstrates that the leadership role of the central bank is of decisive importance in the successful implementation of ESG credit policy. The Central Bank of Uzbekistan needs to increase its activity in this area.

Fourth, the phased model proposed for Uzbekistan's banking sector has been developed taking into account real economic conditions. Its implementation will make a significant contribution to achieving Uzbekistan's sustainable development goals.

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As a promising direction for future research, one may highlight the quantitative assessment of the impact of ESG credit policy on bank profitability and financial stability, as well as the improvement of ESG monitoring systems with the aid of digital technologies — artificial intelligence and big data analytics.

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