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INVESTING BASED ON ESG FACTORS: METHODOLOGICAL APPROACH

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Abstract. The article describes the role and significance of the "ESG" approach in ensuring the implementation of the objectives set by the UN sustainable development goals. The methodological foundations for regulating ESG activities at the international level and the methodology for assessing ESG factors of companies have been studied. Here, recommendations are given for the application of the ESG approach in the national economy.

Key words: ESG factors, green economy, financial instruments, green investments, responsible investments, socially responsible investments, green financing, green projects.

INTRODUCTION

In recent years, participants in international financial relations have increasingly attached importance to the Sustainable Development Goals (SDGs). Governments of various countries, regulatory institutions, development institutions, large companies, stock exchanges and financial market participants are actively involved in the implementation of the tasks included in the BRM. In particular, based on the initiative of the UN, the principles of responsible investment (PRI, UN Principles for Responsible Investment) have been developed, which contain the necessary recommendations for including the analysis of ESG factors in investment activities. Most of the big companies around the world are supporting this initiative. Companies are also trying to ensure that their core goals are aligned with the wishes and desires of community members by considering ESG factors when making investment decisions.

For example, in January 2020, Microsoft announced plans to transition to negative carbon emissions by 2030. Since its founding in 1975, the company has been committed to reducing its carbon footprint. It also announced that it will invest 1 billion US dollars in the Climate Innovation Fund [1].

In our country, investment practice taking into account ESG principles is at the initial stage of formation. Normative legal and methodological bases for investment based on ESG principles have not been developed in the national economy. In addition, most local economic entities do not have sufficient understanding of making investment decisions based on ESG principles. In most cases , economic subjects who have an understanding of this issue do not pay serious attention to the introduction of ESG principles.

Therefore, researching how the application of ESG principles in business processes by local economic entities can benefit them and provide them with opportunities is considered one of the urgent tasks today.

LITERATURE REVIEW

Today, new financial instruments are emerging as a result of global efforts towards sustainable development goals. Institutional investors are focusing on making investment decisions based on ESG, i.e. environmental, social and corporate governance factors. International

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financial institutions support the disclosure of information not related to the company's financial performance, in particular, related to ESG approaches. Many governments are taking the ESG approach to the public policy level. These facts are confirmed by the following sources.

Currently, changes in all aspects of the financial sector are being implemented by introducing sustainable development tools into them. Today, sustainable development is not only noted as a concept, but has become a practically oriented mainstream in the world of business and investment. This, in turn, requires the effective formation and development of the responsible investment (ESG) market [2].

The use of ESG approaches in companies is influenced by external factors, while the increasing interest of foreign investors and public policy in this area is becoming crucial [3].

Responsible investing, or ESG investing, relies on environmental, social and governance factors in the investment decision-making process. At the stage of transition to an informed society and improvement of people's lifestyle, investors do not look at economic efficiency as the main factor in evaluating the feasibility of making investments, but at the same time, they consider criteria such as moral values and spiritual development of a person as a priority. When making investment decisions, economic agents rely not only on the stable growth of the company's financial indicators, but also on information not related to the company's financial indicators, in particular, the principles of environmental protection and social responsibility of these companies [4].

institutional innovation, the application of "green" financing policies leads to increased financial constraints for companies that pollute the environment more. This can change the actions of companies in terms of environmental pollution in a positive way. Encouraging financial institutions and enterprises to assume more environmental and social responsibility through green financing policies can be an effective way to allocate resources and increase the efficiency of green development [5].

RESEARCH METHODOLOGY

The methodological basis of the research includes the theoretical rules related to the application of ESG factors in the financing of projects and investment decisions aimed at achieving "green" economic development provided for in the concept of sustainable development. In the process of scientific research, the method of dialectics was used, which opens up the possibility of dynamically studying economic phenomena in a mutually dependent manner. Graphic methods, grouping and comparison, analysis and synthesis methods were used in the research process as a systematic approach to the research object.

ANALYSIS AND RESULTS

In recent years, representatives of the international community have been increasingly promoting the idea that income from any business should be in line with the generally accepted norms and rules related to environmental protection, social justice and responsibility, and protection of human rights. This concept is directly related to the practical application of ESG principles.

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The concept of "ESG", which combines environmental, social and corporate management factors, was first used in 2004 in a report prepared based on the materials of the conference "Who Cares Wins" held on the basis of a joint initiative of the UN and major financial institutions [6].

Later, based on the initiative of the UN, in cooperation with institutional investors, 6 principles of responsible investment for economic entities were developed (Figure 1).

In terms of responsible investment, economic entities should consider ESG factors when making investments, take into account ESG factors in company management, require disclosure of information related to ESG factors, support the implementation of ESG factors, cooperate with enterprises and organizations that work on the basis of ESG principles, and implement ESG principles. Voluntary principles such as sharing work with others are included.

1 . Consideration of ESG factors in investing;

2. Considering ESG factors in company management;

3. Require disclosure of information related to ESG factors;

4. Support the implementation of ESG factors;

5. Cooperation with enterprises and organizations working on the basis of ESG principles;

6. Share with others the work carried out on the basis of ESG principles.

Figure 1. Responsible, developed on the basis of the UN initiative investment principles [7]

Methodological approaches to the regulation of ESG factors are mainly related to the establishment of rules for disclosure of non-financial reports. In international practice, a number of legal frameworks and initiatives related to the regulation and coordination of ESG activities have been formed. Such legal frameworks and initiatives have the following form (Figure 2).

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1. Legal bases and initiatives related to the regulation of ESG activities in international practice

- international regulation of political or economic associations established on the basis of international agreements between states;
- corporate governance codes;
- national regulation of corporate law, environmental and social issues;
- disclosure of ESG principles by market participants voluntary initiatives.

2. Legal basis of international regulation of ESG activities

- The Paris Agreement on Climate Change;
- UN Sustainable Development Goals (SDGs) until 2030;
- G20 and Organization for Economic Co-operation and Development (OECD) corporate governance principles;
- IHRT's principles of governance for multinational companies;
- IHRT corporate governance principles for state-owned enterprises;
- UN and World Bank road map for transition to a stable financial system;
- 10 principles of the UN Global Compact on human rights, labor relations, environmental protection and anti-corruption;
- A practical guide to incorporating ESG factors into investment processes, developed by the UN's Principles for Responsible Investment (PRI).

Figure 2. Legal frameworks and initiatives related to the regulation of ESG activities at the international level[1]

As part of the global call on climate change, many countries of the world have joined the Paris Agreement on Climate Change. More than 190 countries of the world, which have signed this agreement, have undertaken obligations to achieve the BRM. On the basis of such changes, until recent years, a number of companies have abandoned the voluntary practice of disclosing information that was not institutionally accepted to combat climate change. In its place, a robust ESG ecosystem has been established. The need to solve a number of issues in order to form a reliable ESG ecosystem is on the agenda. These are:

- conceptual frameworks;
- regulatory frameworks;
- evaluation and monitoring process.

Conceptual foundations. In the conceptual basis of the ESG call, it was determined to be based on the "company-society" principle, to recognize the company as a part of society, not a subject of society. It was emphasized that the main focus was not on competition for limited resources, but on voluntary formation of stable relations between members of society.

Regulatory frameworks. The development of appropriate regulatory and legal frameworks for the regulation of ESG activities is of great importance in solving problems related to sustainable development and managing ESG risks. Therefore, the main attention was paid to the

[1]It was compiled by the researcher based on the reports of international organizations.

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development of regulatory and legal frameworks in the following directions, which are directly related to the ESG call. In particular:

- " green " taxonomy;
- Disclosure of ESG risks and environmental impact;
- standardization of manufactured products;
- the procedure for issuing " green " bonds ;
- " green " securities.

"Green" taxonomy. About 30 countries of the world have adopted regulatory frameworks for "green" taxonomy. Most "green" taxonomies adopted in foreign countries have included environmental issues. Only social goals are included in the "green" taxonomy adopted in the European Union and Colombia. Also, unlike other countries, the "green" taxonomy adopted in Mongolia includes issues related to poverty reduction.

In our country, with the Resolution No. 561 of the Cabinet of Ministers of the Republic of Uzbekistan dated October 25, 2023 " On approval of the national taxonomy of the "green" economy " [8], the taxonomy of the national "green" economy consisting of 7 directions was adopted.

The taxonomy approved in the European Union (EU) is considered to be somewhat improved among the legal frameworks adopted for "green" taxonomy in the countries of the world. As a basis for reaching such a conclusion, it is possible to cite the fact that for each direction included in the EU taxonomy, clear quantitative limits and criteria for checking the environmental friendliness have been established. At the same time, the following requirements are set for projects implemented in the EU "green" taxonomy:

- climate change mitigation;
- adaptation to climate change;
- protection and sustainable use of water and marine resources;
- transition to a circular (waste-free) economy;
- prevention and control of pollution of nature and environment;
- biodiversity, ecosystem restoration and protection.

Disclosure of ESG risks and environmental impacts. As a means of assessing the risks associated with climate change, stress tests were first conducted in companies related to the financial sector. As an example, we can cite North American banks. 19 banks located in the North American region have united within the framework of the "Climate Risk Consortium+" initiative and mutually agreed on the joint management of risks related to climate changes.

The consortium will develop step-by-step taxonomies, rules and standards for participating banks and other actors in the network based on current efforts to manage risks related to climate change. In addition, the consortium collaborates with regulators and other senior policy makers and provides information on climate change-specific considerations [9].

After this initiative, large financial institutions also began to recognize the risks associated with climate change as a financial risk. Also, financial market regulators in various countries have moved to introduce mandatory and voluntary requirements for disclosure of important information in order to identify risks related to climate change.

Standardization of manufactured products. The UK's financial market regulator has adopted a standard for mandatory disclosure of companies' plans and information related to the transition

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to carbon neutrality. The Netherlands and France have also adopted a legal framework for mandatory disclosure of information on the carbon footprint of investments made by companies operating in the financial sector . In New Zealand, banks, investment companies and insurance companies are required to disclose important information related to climate change.

for issuing " green " bonds .Issuers can place "green" bonds on national and international capital markets. "Green" in world practiceIn order to issue bonds to the international capital market and enter the international register, it must meet the requirements of the International Capital Market Association (ICMA) and the Climate Bond Initiative (CBI).

According to the methodology of the above-mentioned organizations, the issued bonds are "green"In order to be recognized as bonds, they must comply with the basic principles recognized by the organizations mentioned above. The guiding principles are a set of voluntary rules that embody a defined direction and vision, and are the same for all participants. The guiding principles serve to achieve environmental and social sustainability by enhancing the role of global debt capital markets in financing development.

"Green" securities."Green" securities are one of the important tools in implementing the ESG challenge. As a rule, it is "green" securities that are subject to regulation. At the same time, in countries such as Argentina, Chile, Morocco and Senegal, along with "green" securities, sustainable and social bonds are also regulated. Guidelines or standards for the regulation of sustainable bonds can be approved directly by the regulatory body or the stock exchange. In addition, there may be large associations composed of different countries, such as the EU or the Association of Southeast Asian Nations (ASEAN), which develop rules or standards in this regard. "Green" securities standards are linked to taxonomy or projects in specific areas that need to be implemented.

Evaluation and monitoring process. The assessment and monitoring process is of particular importance in the formation of the ESG ecosystem. In this process, special attention is paid to the introduction of ESG standards and the determination of company ratings in this regard.

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Table 1

Characteristics of international standards related to ESG[2]

No	Naming of international standards	Characteristics of international standards
1.	Global Reporting Initiative's (GRI)	GRI is one of the most widely used standards in global ESG practice. The GRI includes comprehensive reporting requirements for the governance, economic, environmental and social aspects of a company's operations. This standard was developed in 2000 in response to the environmental damage caused by the Exxon Valdez oil spill. According to KPMG's 2020 Sustainability Report, 96% of the world's 250 largest companies have reported on their sustainability activities. 73% of the companies that submitted a report in this direction are based on the GRI system.
2.	Sustainability Accounting Standards Board's (SASB)	Sustainability reporting standards cover 77 industry sectors. A minimum set of reporting topics and a set of indicators for performance quantification and benchmarking are provided for each industry sector. From August 2022, responsibility for SASB standards has been taken over by the International Standards Board for Sustainable Development (ISSB), which is part of the International Financial Reporting Standards (IFRS) Foundation. The ISSB, in turn, is committed to supporting, improving and developing SASB standards.
3.	Integrated reporting (IR, Integrated Reporting)	The concept of IR was originally published by the International Integrated Reporting Council (IIRC). The IIRC was established in August 2010 with the aim of creating a globally recognized reporting system for companies to create specific value over time. IR is based on 3 fundamental concepts. These are: creating, maintaining or reducing value for the company and others; financial, production, human, health capital and social relations; the process of creating, storing or destroying value. In June 2021, the International Integrated Reporting Council (IIRC) merged with the Sustainable Development Accounting Standards Board (SASB). As a result of the merger, the Value Reporting Foundation (VRF) was established. The goal of the merger is to provide investors and corporations with a comprehensive system of corporate reporting. In this case, the value of the enterprise is determined according to the necessary standards.
4.	Recommendations of the Task Force on Climate-related Financial Disclosure (TCFD)	The working group examines the health risks associated with climate change, the risks associated with liability, and the risks associated with transitions to a low-carbon economy. It also analyzes the effectiveness of information disclosure in various sectors of the economy. In this direction, the main attention is paid to the risks associated with climate changes and their financial aspects. Also, recommendations are based on a scenario approach. Recommendations, in turn, apply to financial institutions and non-profit organizations. The TCFD recommendations were introduced in 2017 to help investors, lenders and insurers obtain the information they need to assess the risks and opportunities associated with climate change. Implementation of the working group's recommendations is voluntary. However, in countries such as Brazil, Japan, Singapore, Switzerland, Great Britain, the application of the recommendations of the working group is becoming a mandatory condition. According to the 2022 TCFD report, as of October 2022, more than 3,800 companies have submitted reports based on TCFD recommendations.
5.	Non-Financial Disclosure Standards for Greenhouse Gas Emissions (CDP, Carbon Disclosure Project)	CDP Worldwide is a non-profit organization founded in 2000. This organization manages a global system for disclosure of information on the environmental impact management of investors, companies, cities, regions and regions. More than 20,000 companies from around the world complete the survey on climate change, water resources and forestry provided by CDP. The CDP questionnaire is mutually agreed with the TCFD.
6.	International Standards Board for Sustainable Development (ISSB, International Sustainability Standards Board)	ISSB has released two global standards for corporate disclosure of information on sustainable development. These are International Financial Reporting Standards IFRS S1 "General Requirements for Financial Information Disclosure Related to Sustainable Development" and IFRS S2 "Disclosure of Information Related to Climate Change". It is noteworthy that these standards came into force on January 1, 2024.
7.	European Union Corporate Sustainability Reporting Directive (CSRD, Corporate Sustainability Reporting Directive)	From January 5, 2023, the European Union's Corporate Sustainability Reporting Directive (CSRD) came into force. This directive affects more than 50,000 companies in Europe and more than 10,000 companies outside Europe. The standards cover all aspects of environmental, social and governance issues, including climate change, biodiversity and human rights. These standards help investors to understand how the companies in which they invest are making a sustainable development impact.

[2]It was compiled by the researcher based on the information on the official websites of international organizations and associations.

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In accordance with the table above, we consider a number of international standards related to ESG. Most of the international standards for sustainable development contained in it are non-binding. That is, disclosure of non-financial information by companies is based on discretion. However, it is mandatory to submit non-financial statements based on the IFRS S1 and IFRS S2 standards provided by the International Sustainability Standards Board (ISSB) and the European Union's Corporate Reporting Guidelines on Sustainable Development (CSRD).

Guidelines are published and regularly updated by the developers of international ESG standards to help understand the requirements for corporate ESG practices and what ESG-related topics should be disclosed. In this way, ESG standards have an impact on decisions regarding the direction of the company's ESG strategy.

In international practice, in addition to presenting reports based on ESG and Sustainable Development standards, there is a practice of determining ESG ratings and ESG rankings of companies. ESG ratings of companies can be determined by international agencies as well as national rating agencies.

Today, there are about 160 entities operating in the global market that determine ESG ratings or offer analytical information packages using ESG data. There are commercial and not-for-profit organizations that offer comprehensive or specialized ESG rating data sets.

Among the leading companies in the international market for ESG ratings, the following can be included:

- ISS (Institutional Shareholder Services) ESG;
- Sustainalytics ESG Risk Rating;
- Moody's, MSCI and S&P Global company ESG ratings;
- Bloomberg ESG scores;
- Fitch Climate Vulnerability Scores (Fitch Ratings);
- FTSE Russell's ESG Ratings;
- Thompson Reuters ESG Scores.

As mentioned above, the number of ESG rating organizations in the global market is increasing year by year. In turn, each organization providing such services has its own methodology for determining ESG ratings and they differ from each other. In addition, some organizations ESG ratingbased on public information without sending an official request to the company. Therefore , when the ESG indicators of the same company are evaluated by different organizations, its results differ significantly from each other.

For example, studies conducted by Florian Berg, a researcher at the MIT Sloan School of Management, show that six out of ten different ESG ratings match. A comparison of the MSCI and Sustainalytics ratings for S&P Global 1200 companies by CSRHub found that the correlation between the two ratings is weak (0.32). This indicator differs several times from the indicators used to determine credit ratings. Usually, credit scores match in 99% of cases. For example, Moody's and S&P credit ratings have a very strong positive correlation (0.90) [10].

Therefore, the ESG rating system based on different standards is an obstacle for market participants to make informed decisions when investing capital taking into account ESG. This situation, in turn, means that different ESG standards and rating methodologies need to be reviewed from the point of view of integration.

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CONCLUSIONS

In our country, the practice of making investments based on ESG factors is at the initial stage of the formation process. In our opinion, the state should be the leader in the development of such activities. For this, it is necessary to include ESG-related provisions and frameworks for regulating and promoting ESG activities in legislative documents.

1. The lack of a single set of standards and evaluation methodology for evaluating the ESG indicators of companies, the lack of clear identification of the regulators of ESG activities in the sector of economic entities, and the absence of organizations for determining the ESG rating are obstacles to the development of ESG investment practices in Uzbekistan. This situation creates uncertainty for investors and makes it difficult to make clear decisions in this regard.
2. In order to develop ESG activities in Uzbekistan, it is recommended to issue "green" and "social" bonds and develop "green" loans by commercial banks, create new types of "green" energy and actively use them, as well as use environmental labels.
3. In Uzbekistan, it is necessary to make it mandatory to apply ESG requirements in the following types of activities and directions:

- at the initial stage, large and medium-sized business entities, and at the next stage, all small business entities submit an ESG report;
- reflection of ESG factors in the feasibility study (business plan) of medium and large investment projects;
- compliance of projects with ESG standards when allocating loans to medium and large investment projects by commercial banks;
- inclusion of ESG principles in the requirements of investment portfolio formation by commercial banks, insurance companies and investment funds.

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