The Role of Hard and Soft Law in Securing Sustainable Investment in the Russian Federation

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Abstract: This article examines the complex relationship between sustainable development, climate change, and the evolving landscape of investment, particularly through the lens of ESG (Environmental, Social, and Governance) principles. With an emphasis on the legal frameworks and soft law practices that govern sustainable investment, the study highlights the pivotal role of incorporating ESG factors into corporate governance and investment decision-making to foster environmental sustainability and social equity. It examines the legislative acts at both global and national levels, with a specific focus on Russian law and its application in areas like the Arctic zone, where sustainable investment regulations are crucial. The paper also critically assesses the terminological ambiguities surrounding sustainable development and ESG investing, pointing out the challenges of achieving a universally accepted definition and the potential implications for policy and practice. Through a detailed exploration of hard and soft law mechanisms, the study underscores the significant impact of non-binding guidelines and ethical standards in shaping investment strategies that prioritize long-term sustainability over short-term gains.

1 INTRODUCTION

Issues of sustainable development and combating climate change are increasingly coming under the purview of executive authorities and financial market regulators across various nations. The prevailing paradigm in investment currently favors a goal-setting approach known as investing for sustainability impact (hereafter IFSI). This approach mandates that in making investment decisions, investors and entrepreneurs should aim to achieve outcomes from investment projects that not only yield maximum positive effects for both the investor and the environment, including communities of indigenous and minority peoples residing in the regions of investment project implementation, but also, in the long term, reduce the overall negative impact from the project's realization (UNEP FI, 2021). The Sustainable Development Agenda up to 2030, adopted by the resolution of the United Nations General Assembly on 25 September 2015, and the Paris Agreement of 12 December 2015, ratified by the 21st Conference of the Parties to the United Nations Framework Convention on Climate Change and signed on behalf of the Russian Federation in New York on 22 April 2016, have established a legal and ideological foundation for a new global redistribution of capital flows in favor of markets that promote sustainable development goals.

In this context, the field known as "Law of Sustainable Entrepreneurship" (Czarnezki, 2023), which is grounded in the core principles of ESG investing, gains popularity, details of which will be elaborated upon subsequently. In many major legal firms, departments dealing with sustainable business development and sustainable investing are being established (Myers, 2022). Indeed, sustainable investing necessitates the consideration of environmental, social, and governance factors in decision-making processes to better manage risks and ensure sustainable and long-term investment returns, as well as to effect positive social change and achieve socially beneficial objectives (Belitskaya, 2023).

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The incorporation of ESG factors and sustainable development issues into corporate governance and in the formation of value chains enhances business resilience to market volatility in the short, medium, and long term. Consequently, companies can protect and strengthen their market positions, create added value for themselves and stakeholders, increase sales, develop new market segments, enhance brand reputation, improve operational efficiency, foster product innovations, and reduce staff turnover.

This work will primarily explore ESG investing as the most adaptive and accurate concept underlying investment decision-making.

2 METHODOLOGY

The methodology encompasses an examination of legal frameworks and statutes that govern sustainable investment, as well as the application of soft law practices, including guidelines, advisory directives, and best practices. This analysis scrutinizes pivotal legislation delineating the parameters of sustainable development and investment at both global and national levels, incorporating international treaties and standards, alongside Russian legislation. A particular focus is given to the evaluation of hard law norms, such as federal laws that regulate investment activities within Russia's Arctic zone, and legislation aimed at territorial development and urban planning within the Russian Federation. Additionally, considerable attention is devoted to the analysis of soft law, exploring its role and significance in the regulation of sustainable investment. Examples of soft law are examined, including corporate codes of ethics, ethical standards, as well as recommendations and advisory directives from authoritative bodies and international organizations, with an emphasis on adapting the text to align more closely with the style of a native English speaker.

3 RESULTS OF RESEARCH

3.1 Terminological Considerations

It is pertinent to note that the term "sustainable development" has increasingly found its way into both academic discourse and the texts of legislative acts. Despite its inaugural usage in 1987 within the United Nations General Assembly's report "Our Common Future", which articulated humanity's capacity to forge development in a sustainable and enduring manner, meeting the needs of the present without compromising the ability of future generations to meet their own needs (United Nations, 1987), a consensus on a unified interpretation of this term remains elusive. This conceptualization of sustainable development globally implies a model of progress that satisfies current demands without detriment to future generations' capacity to fulfill their needs.

A similar state of ambiguity surrounds ESG investing. This term, too, lacks a homogeneous and universally accepted definition across both international and national contexts. For instance, the Russian standard GOST R 70339-2022 provides a definition of ESG as environmental and social factors, along with corporate governance elements, observed by companies and organizations of all ownership types, which are considered by institutional investors and financing entities in their investment strategies and credit policies. Meanwhile, the Russian Central Bank's roadmaps interpret ESG as sustainable development principles related to environmental (including ecological and climate change-related), social, and corporate governance aspects. Frequently, terms such as "factors", “standards” (Posulikhina, 2022), "principles" (Majorina, 2021), and "strategies" (Baranina, 2022) used with the ESG acronym.

ESG encompasses non-financial foundations potentially impacting companies' financial outcomes and, in a more traditional sense, sustainable development measures, along with practices in ecology, social responsibility, and corporate governance. It is elaborated that ESG, particularly for regulatory purposes, should broadly include "all information on ecology, social sphere, or governance that is or could become significant to the reporting company or its investors." (Pollman, 2021) This distinction is drawn between ESG, which is perceived as pertaining to risk management, and CSR, which relates to ethical and moral social obligations of a corporation, though ESG is sometimes also linked to social benefits.

Highlighting that adherence to ESG principles or the consideration of ESG factors in investment decision-making is not a panacea is crucial, as the concept itself is not devoid of drawbacks, which can be categorized into intrinsic or substantive and external or introduced shortcomings. The intrinsic flaw is identified as the absence of objective and reliable data on ESG efficacy. Some studies suggest that organizations considering environmental, social, and economic factors in responsible investment implementation demonstrate superior operational

performance (Arabesque, 2015). However, it is evident that not all organizational activities are subject to public reporting, leading to speculation about compliance with many ESG elements. Moreover, the relevance of qualitative versus quantitative indicators is not always clear, potentially leading to an "imbalance" in assessing these principles' effectiveness, favoring formal over substantive indicators.

The external deficiency manifests as more organizations adopt ESG approaches, resulting in an increasing number of metrics and criteria for their effectiveness. Presently, a plethora of organizations assess compliance with ESG principles, including Bloomberg ESG Disclosure Score, FTSE Russell ESG Rating, MSCI ESG Ratings, Refinitiv ESG Scores, EcoVadis CSR Rating, ISS-Oekem Corporate Rating, RobecoSAM Corporate Sustainability Assessment, Sustainalytics Company ESG Ratings, and TruValue Labs Insights360 Scores, among others. The surge in popularity of sustainable investment and the implementation of ESG principles has led to a second introduced flaw - a political one. For instance, Texas has enacted legislation prohibiting public authorities from conducting business with organizations guided by ESG principles in their operations, largely because the oil industry in Texas does not fit within these rules, thus deterring investors from engaging with organizations in this sector within the state. Similarly, in Florida, pension fund managers are prohibited from considering ESG factors in their investment policy choices. This limitation must be considered by organizations intending to operate in these states or with entities registered within them (McGlashan, 2022).

3.2 Regulation of ESG Investing in accordance with Russian Law

In its broadest sense, the concept of ESG pertains to the measurement and verification of organizational effectiveness, with each constituent element of the acronym—Environmental (E), Social (S), and Governance (G)—denoting distinct aspects that organizations are expected to consider in their decision-making processes. These aspects are regulated by both 'hard' and 'soft' law, reflecting a balance between binding legal norms and non-mandatory guidance.

Emerging from established practices, the Environmental (E) component assesses how organizations contribute to sustainable development from an ecological perspective. Environmental factors in this category account for a company's use of natural resources and the impact of its activities on the environment. Companies committed to implementing ESG principles gather and benchmark their performance metrics against ESG indicators, which may include the use of renewable energy sources, climate change risks, regulatory risks, and more.

The Social (S) dimension evaluates an organization's long-term positioning, the reputational value derived from its market conduct, the stability and effectiveness of its workforce over the long haul, potential costs of labor disputes, political risk of community conflicts, and legal and reputational risks associated with employment practices within its supply chain, among other factors. The social aspect of ESG concerns how a company manages its relationships with employees and local communities, for instance, in the context of the Arctic region, with indigenous and minority peoples.

Governance (G) refers specifically to corporate governance, encompassing decision-making factors and consideration of the interests of participants/founders of the organization, as well as how the company is managed.

Concluding this section, it can be noted that ESG analysis is associated with identifying environmental, social, and governance risks that could influence decision-making at the organizational level. This process can be facilitated through two distinct yet interconnected regulatory mechanisms: hard law and soft law. It is rightly observed in the literature that contemporary issues of sustainable development and investment are regulated by virtually all branches of law, from competition law to corporate law, underscoring the comprehensive legal engagement with sustainability and governance (Lights, 2019).

3.2.1. The Framework of Hard Law

Hard law represents the conventional "positive" law that regulates specific aspects of ESG investing. When referring to "hard" law, it entails universally binding, formally defined rules of conduct that all entities engaged in investment activities must comply with.

In the Russian Federation, hard law in the sphere of sustainable investment regulation, for example in the Arctic region, is primarily represented by the Federal Law of 13.07.2020 No. 193-FZ "On State Support for Entrepreneurial Activities in the Arctic Zone of the Russian Federation." The main aim of this law is to establish an economic basis for accelerated social development and improved quality of life in the Arctic Zone of the Russian Federation. This law also

establishes a special managing company responsible for receiving applications for investment activity agreements, concluding investment activity agreements, and maintaining the registry of Arctic Zone residents, among other duties.

Furthermore, the Federal Law of 29.07.2017 No. 218-FZ "On the Public Law Company 'Fund for the Development of Territories' and on Amendments to Certain Legislative Acts of the Russian Federation" established the Territory Development Fund (hereinafter referred to as the Fund). One of the Fund's objectives is to facilitate sustainable socio-economic development, attract investments for the development of existing and the creation of new productions, develop transportation and other infrastructures, construction, and enhance the living standards and quality of life of citizens in accordance with this Federal Law, other federal laws, and regulatory acts of the Government of the Russian Federation.

Significantly, the Urban Planning Code of the Russian Federation consolidates the overarching statutes for territorial development aligned with sustainable growth objectives. Infractions of these statutes may precipitate the annulment of land allocations to developers. Judicial precedents have demonstrated instances where planning documentation for territories, ostensibly crafted not to fortify sustainable territorial development but to restrict the permissible utilizations of auctioned land plots, was adjudged, rendering the land allocation auctions null and void.

Regulation through hard law also occurs at the level of sub-legal acts. For instance, the Order of the Ministry for the Development of the Russian Far East No. 110 of 13.08.2020 "On Approval of the Model Form of Agreement on Investment Activity in the Arctic Zone of the Russian Federation" established the form of agreement on investment activity, the principal provisions of which lay the foundation for future investment agreements. By Order of the Government of the Russian Federation No. 1912-r of 14.07.2021 "On Approval of the Goals and Main Directions of Sustainable (Including Green) Development of the Russian Federation," with the aim of developing investment activity and attracting non-budgetary funds to projects aimed at achieving the national development goals of the Russian Federation in the field of green financing and sustainable development, the attached goals and main directions of sustainable (including green) development of the Russian Federation were approved.

Acts of the subjects of the Russian Federation also play a significant role, as authorities at the level of individual subjects can more specifically assess which directions of sustainable investment regulation are relevant for them. For instance, the active Law of Saint Petersburg of 19.12.2018 No. 771–164 "On the Strategy for Socio-Economic Development of Saint Petersburg for the Period up to 2035" sets as a goal the improvement of the physical culture level among Saint Petersburg residents and the development of a reserve training system for Russian national sports teams. Indicators include the proportion of Saint Petersburg residents regularly engaging in physical culture and sports and the satisfaction level of the population with the conditions for such activities, with the latter indicator measured solely through sociological methods of interaction with the population. It should be noted, however, that such an indicator of achieving sustainable development goals is unlikely to reflect the actual situation of strategy implementation.

Thus, one of the key challenges in regulating investment activities in the Russian Federation is undoubtedly the lack of sufficiently developed legal regulation of investment activities at the level of laws and sub-legal regulatory acts.

3.2.2 The Domain of Soft Law

In this regard, soft law assumes a critical role in facilitating judicious investment practices. This genre of law, comprised of acts and documents, is characterized, as scholars have observed, more by its moral and political force than by its juridical clout (Davydov, 2022). The notion of "soft law" was originally conceived in the United States to describe forms of secondary regulation such as the United States Code or model codes (Lyubchenko, 2017). Soft law does not necessitate formal recognition or incorporation into the legislative framework of a given state; rather, the entities concerned determine the significance and potential utility of adopting such behavioral norms, including states which are guided not by the explicit legal force of these norms but by moral and political considerations. In one of the most authoritative works dedicated to the regulation of sustainable investment at the organizational level - "Private Environmental Governance" authored by Michael P. Vandenbergh in 2013 - it is noted that environmental regulation has evolved from primarily positive state law to private law established by organizations (Vandenbergh, 2013).

Typically, soft law is crafted by the subjects of investment activity themselves (though it may also be

developed at the recommendation level, issued by authorized bodies), emerging from an extensive development of behavioral models and so-called "best practices" that inform the creation of soft law. Adherence to the behavioral model devised by its architects is ensured not through the compulsion of state enforcement but through the authority of the community that has established the pertinent soft law instrument. Soft law has gained considerable traction in the investment sphere, especially in regions inhabited by indigenous and minority peoples, including the Arctic region. Additionally, corporate law acts, such as codes of professional ethics, can potentially be classified under soft law (Kasatkina, 2022). The literature highlights that the presence of such a "soft" governance tool within a corporation indicates a well-established system of corporate governance and a commitment to the norms of fair business conduct. Essentially, soft law reflects the narrative of the business community at large, addressing current investment issues and the implementation of the sustainable investment concept (Goncharova, 2022).

However, it is imperative to acknowledge that, given the nascent state of investment entrepreneurship in Russia, soft law embodied in recommendations and methodological guidelines issued by authorized bodies acquires significant importance.

For example, the Bank of Russia advises investors to consider:

a) Among environmental factors, this includes data on greenhouse gas emissions, energy consumption, water usage, waste generation, information on water management and waste treatment, the company's environmental protection policy, and its expenditures in this sphere, etc.

b) Among social factors, this encompasses working conditions of employees, payroll expenses, average salary levels, staff turnover, occupational safety measures, data on accidents, expenditures on employee training, violations of workers' rights, approaches to human capital formation, contributions to regional development, and philanthropy.

c) As for corporate governance factors, consideration should be given to the organization's capital structure, the presence of controlling parties, the history of the organization's management, its role and place in the state's economy, the safeguarding of securities holders' rights during corporate actions, the effectiveness of the management system, including the composition and the results of the effectiveness evaluation of the board of directors' activities, the implementation of internal control and risk management, internal audit, and so forth.

Additionally, the Bank of Russia has developed a checklist for assessing the quality of the developing (or developed) sustainable development strategy (SDS) and/or climate transition strategy (CTS), which is as follows:

Table 1: Sustainable Development (SDS) and Climate Transition (CTS) Strategy Evaluation Checklist.

No.	Element	Yes/ No
1	The SDS and/or CTS include(s) a justification for the integration of sustainable development and/or climate change issues into the Organization's activities and the development of the SDS and/or CTS.	
2	The SDS and/or CTS align(s) with the corporate-wide strategy and other strategic planning documents of the Organization.	
3	The SDS and/or CTS set(s) goals and timelines for their achievement.	
4	The SDS and/or CTS establish(es) ambitious goals (compared to industry-average indicators) within the scope of the SDS and/or CTS.	
5	The SDS and/or CTS are developed taking into account scientifically based forecasts and scenarios of events, the most current scientific data and results recognized at the national and international levels.	
6	The SDS and/or CTS provide for the timelines and circumstances under which a review of the performance indicators, the list of initiatives included therein, and the planned measures for their achievement is carried out.	
7	The SDS and/or CTS take into account a list of significant risks and opportunities related to sustainable development for the Organization.	
8	The SDS and/or CTS reflect the potential negative effects of implementing the goals set forth therein.	
9	The SDS and/or CTS contain a description of the impact of the implementation of the SDS and/or CTS for both stakeholders within the Organization and for external interested parties.	
10	The SDS and/or CTS describe how the Organization integrates issues of sustainable development and climate change in organizing corporate governance. These issues can also be integrated into other documents, e.g., a sustainable development policy.	
12	The implementation plan contains a description of how the Organization plans to implement relevant internal policies and requirements into its operational activities, minimize risks and maximize opportunities associated with sustainable development, ensure the implementation of technological solutions for sustainable development and climate change, ensure sufficient levels of financial, personnel, and other resources to achieve the goals of the SDS and/or CTS, implement climate projects	

	where applicable, align the SDS and/or CTS with other strategic documents and policies of the Organization including investment policy and asset management policy, build the organization's capacity in the field of sustainable development or climate change, and enhance the relevant qualifications of employees, organize a system of employee motivation for achieving the Organization's goals in sustainable development and climate change, and interact with counterparties to increase the effect of implementing the SDS and CTS.	
13	The implementation plan is developed for the period of the SDS and/or CTS implementation, and if the timelines for achieving the final values of target performance indicators of the Organization's activities in sustainable development or climate change exceed the traditional time horizons of strategic planning, then for a shorter period with the indication of the terms for its update.	

These acts are not universally mandatory but rather recommendations that should be taken into account by organizations seeking to attract investment, including foreign investment.

4 CONCLUSIONS

It is to be concluded that presently, organizations are increasingly inclined to utilize soft law instruments in the implementation of investment projects and in the development of investment policies. Organizations engaged in investment are paying more attention to whether their potential counterparts consider the agenda of sustainable development and climate change, and whether they ensure informational transparency of activities in terms of parameters related to sustainable development.

An illustrative example of the implementation of soft law norms is demonstrated by Schroder Investment Management, which offers its clients the creation of a "sustainable development budget"—i.e., investing in green projects as part of the diversification of investment projects. Thus, indirectly encouraging, firstly, investment in environmentally safe and clean enterprises by investors and, secondly, by entrepreneurs—to implement projects considering ESG factors in decision-making.

In conclusion, it should be asserted that although regulatory acts play a significant role in regulating and ensuring responsible and environmental investing, their importance is secondary to soft law, which predominates in the investment sphere.

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