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# Sustainable Mining: Trends and developments in responsible financing

Communiqué, May 2011

## Introduction

Oxfam Australia and the Melbourne Business School (Asia Pacific Social Impact Leadership Centre) partnered to host our second sustainable mining symposium. The symposium was held in May 2011. This year, the focus was on trends and developments in responsible financing of mining sector activities.

The symposium provided information and stimulated discussion on responsible financing of Australian mining operations overseas. Topics discussed included project finance due diligence<sup>1</sup>, policy frameworks for investment, different approaches to financing, the role of social and environmental impact assessments, and revenue transparency and reporting. Participants also discussed the application of environmental, social and corporate governance (ESG) frameworks for the extractive industry sector, and lessons learnt from financing in the hydropower sector.

Participants included industry representatives from large and small mining companies, industry associations, financial institutions, fund managers, financial analysts and technical assessors. The symposium was also well attended by Australian Government representatives from the Treasury, the Department of Foreign Affairs Defence and Trade, the Department of Resources and Energy, and the Export Finance Insurance Corporation (EFIC) — the Australian Government's export credit agency — itself a financier of Australian mining operations overseas.

The opening address outlined Oxfam Australia's interest in responsible financing and sustainable mining and the positive role that mining can play in poverty alleviation. The need to develop and implement due diligence risk frameworks was emphasised. Such frameworks can identify, prevent, mitigate and remedy adverse project impacts on communities, and, by extension, reduce investment risks.

Social and environmental impact assessments are an important part of the due diligence process and should include assessments of human rights and gender risks. Identification of risks to local communities is essential in a world where people's rights to land and water are increasingly at risk.

The participants heard about some recent international developments to strengthen due diligence and regulatory frameworks that promote responsible business conduct. This includes the revenue transparency provisions of the Dodd Frank legislation in the United States and growing support for the Extractive Industries Transparency Initiative. The updated *OECD Guidelines for Multinational Enterprises* now include a chapter on human rights and strengthened guidance on supply chain responsibilities and due diligence through business relationships, including financial institutions.

Representatives from the Australian Government identified the challenge of a single definition of sustainable mining.

<sup>1</sup> In the context of this symposium, due diligence is a risk management system that will enable financiers to identify, prevent and mitigate actual and perceived adverse impacts that the provision of project finance may cause or contribute to, either directly or indirectly.

This will vary significantly depending on “which department is asked”, but it is likely to include an understanding of mining in the context of being socially responsible, commercially viable, environmentally sound and using appropriate technology. There is high level support for sustainable mining, which is increasingly recognised as “resource diplomacy”.

The Melbourne Business School highlighted the importance of collaborative efforts to create innovation and ensure “sustained effort” to promote responsible financing decisions. Effective partnerships between government, business and civil society are required to achieve tangible improvements in mining governance and a more equitable share of resource wealth.

The symposium participants were challenged to think about how to innovate and identify “unlikely partners for change” recognising that cross-sector collaboration is essential for change. Financing decisions directly impact the communities where projects are located. Innovation and collaboration are therefore essential if financiers are to be facilitators of positive change.

## Background

There is global recognition that financial institutions have significant influence and leverage on business practice through project finance, and that disclosure, transparency and accountability are critical factors for responsible financing.

Private sector investment is an important driver of economic growth and poverty reduction, provided that appropriate regulations and governance systems are in place. However, without adherence to human rights standards, mining can cause loss of land and livelihoods, degradation of land and waterways, and increased violence and conflict. The most marginalised members of communities – such as women, children and indigenous peoples — tend to be excluded from the economic benefits of mining and bear the brunt of any negative social and

environmental impacts. Responsible investment is critical to promoting sustainable mining and recognises that mining can contribute to poverty reduction in resource-rich, developing countries.

Australian mining companies operating overseas face significant challenges in relation to respecting human rights, especially those that operate in high-risk, conflict-prone countries. With so many Australian companies operating in countries in Africa, and throughout the Asia-Pacific region, an approach to managing business decisions and practice that is founded on upholding human rights is particularly necessary.

The symposium confirmed the growing appetite for risk, including capital investment in emerging economies, conflict-prone countries and geographic regions with weak governance. There has been a massive increase in cross-border trade investment, led by Australian, Canadian and Brazilian companies. There has been a 90% increase in mergers and acquisitions, and an increase in “mega-deals” exceeding \$1 billion. High-value commodity prices and natural resource scarcity are driving investment competition.

The finance sector is in a strong position to influence the impact of mining operations in “high-risk” locations by demanding robust due diligence. To do this, financial institutions, fund managers and analysts are increasingly recognising the need to better understand and manage risk. Questions remain as to how this increased appetite for risk is priced into project evaluations. It was suggested by one symposium participant that “the winners will be those who bring strategic value, knowledge and technological transfer, and not just capital to deal”.

Foreign direct investment can promote growth, but the benefits can be lost through poor governance and ineffective regulation. Revenue transparency has come to the fore globally. However, the challenge is to have conversations on transparency and accountability with emerging economies whose governments may not share the view

that transparency and accountability are important, but may instead feel they have a sovereign right to exploit resources as they see fit.

Access to, and the use of, land and water was identified as a key challenge for the mining sector. Managing relationships and avoiding conflict with project-affected communities and respecting indigenous peoples’ right to free, prior and informed consent are critical issues that will continue to impact on operations and investment.

## Securing finance for mining projects

The symposium participants heard that for some mining companies, maintaining access to mineral resources and achieving a social licence to operate are key drivers of social and environmental practice. Community dissatisfaction is a major risk for mining companies and can, in some instances, present a bigger challenge than country or sovereign risks. How mining companies manage conflict and community unrest matters to investors. Social and environmental impact management follows a hierarchy where impacts are avoided in the first instance, mitigated if they can’t be avoided and restored or offset as a final option. This approach resonated with many participants.

The *International Finance Corporation’s Performance Standards on Social and Environment Sustainability* are important for setting minimum standards or benchmarks. However, they are not a substitute for investing in community-level relationships that form the basis of a company’s social licence to operate. Some companies identified the difficulty in obtaining finance from any source without demonstrating compliance with the performance standards. Others alluded to the changing nature of global capital flows and the rise of new investors and financiers.

Participants heard of tensions between competing land users and the need for the mining sector to better manage land use risks — this is critical in the context of increased exploration activity in ‘high risk’ countries. How mining companies

manage conflict and community unrest “can matter more” to investors than country risk. Investor confidence and shareholders are increasingly concerned by “production disruption”.

Another challenge discussed was the need for companies to help address growing inequality (often directly driven by large extractive industry projects) and to ensure that the benefits of extractive industry projects are more evenly distributed both in directly-impacted communities and across the whole nation where projects are located. Community engagement is critical to reducing risk and securing finance, a theme that also emerged during the 2010 symposium. Sustainable community development initiatives — including community health and local business development — should exist alongside community engagement to ensure projects make a positive change.

## Responsible project financing: a banker’s perspective

Financiers — private, multilateral and government — outlined their approaches to responsible project financing. The importance of the IFC’s performance standards was again highlighted. The symposium participants learned that the performance standards had recently been revised and now include strengthened provisions in relation to human rights protections, free prior and informed consent, climate change, supply chain management and contract disclosure. Many of these are critical issues for the mining sector, especially the need for companies to gain the free prior and informed consent of indigenous peoples for use of their lands. The debate about “what consent means” was acknowledged. Free prior and informed consent does not automatically provide a “veto” but it does change the rules for how consultation with and participation of affected people takes place.

Reputational risks for financiers are increasingly linked to “sensitive sectors” with complex ESG issues such as

resettlement, human rights and tailings management. An additional risk raised was in relation to benefit-sharing arrangements between companies, governments and local communities. The role of the Extractive Industries Transparency Initiative as a means to help provide improved transparency was noted.

Despite best efforts to ensure that financing decisions are responsible decisions, financiers do face many challenges. These challenges include limited capacity in some mining companies to undertake due diligence which can then limit financiers’ risk assessment processes. Access to risk information and credible, independent documentation and assessment is important (and problematic) for financiers. Additionally, financiers can have limited influence or leverage themselves, especially for large projects with multiple financiers. The challenges are increased through the growing complexity of financial arrangements and if not all the financiers are Equator Principle signatories.

## Applying an ESG framework to extractive investments

Investors indicated an increased use of ESG frameworks to manage risks in the mining sector. All speakers emphasised that ESG risks can quickly become financial risks for investors and mining companies themselves.

Investors are particularly keen to understand and minimise risks related to bribery and corruption, including along the supply chain. Investors assess company management systems, the location of the mine project and number of joint venture partners to determine bribery risks. Resettlement and land ownership were additional highlighted risk areas. The difficulties in properly assessing resettlement and land issues in countries prone to conflict and weak governance were noted.

Risks and financing decisions specific to gold mining were flagged in a comparative case study (Africa and

Asia). Some investors are reluctant to ‘invest in gold’ due to comparatively shorter life spans and the technical and environmental challenges specific to gold extraction, particularly involving cyanide processing. These include:

- tailings storage on seismic faults;
- dam security, water quality and site pollution;
- deep sea tailings placement;
- site security and conflict; and
- artisanal mining.

Investors use several standards to analyse ESG risks. These include the *OECD Guidelines for Multinational Enterprises*, the *Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework* and the Extractive Industries Transparency Initiative. The OECD Guidelines and the UN framework both provide useful guidance on due diligence and its application to operations and business relationships. The investors noted that reporting and disclosure are a critical part of managing ESG risk.

Use of the Equator Principles assists financiers to categorise projects within in an ESG lens, as either:

- projects with potential significant adverse social or environmental impacts that are diverse, irreversible, or unprecedented (Category A);
- projects with potential limited adverse social or environmental impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures (Category B); and
- projects with minimal or no social or environmental impacts (Category C).

One the key drawbacks is the voluntary nature of the Equator Principles — the lack of transparency, ad-hoc implementation and monitoring, and the absence of an external compliance mechanism. Nonetheless, the Equator Principles are an important mechanism.

## Lessons in sustainable financing: hydropower and mining

The symposium participants heard that the social and environmental risks associated with large hydropower projects are similar to many of the risks associated with mining, although with hydropower there are additional risks. Key risks include environmental impacts associated with access roads, water quality and inundation, operating in sensitive ecosystems, and resettlement and livelihood restoration.

Civil society and other stakeholders are demanding a more rigorous approach to finance decision-making in both the mining and hydropower sectors. A key lesson from the hydropower sector includes the need to properly identify social and environmental opportunities, challenges and, importantly, deal-breakers, for individual projects. This lesson resonated with participants more familiar with the mining sector.

The participants also heard about the involvement of the Equator Principles banks in the Hydropower Sustainability Assessment Forum (HSAF). HSAF is a multi-stakeholder initiative that aims to develop assessment tools to improve social and environmental practice in the hydropower sector. Large dams trigger many of IFC performance standards and present some very challenging issues, including for financiers. There is no specific IFC environmental, health and safety guideline for the sector, yet this guidance is considered to be necessary. Participants heard that the Equator Principles banks are keen to ensure alignment of the HSAF with the IFC performance standards.

## Themes and conclusions

There was general agreement that oil, gas and mining companies, and the financial institutions that support them, are operating in an increasingly complex landscape characterised by financial and other risks. The scale and speed of projects are, in themselves, challenges for responsible financing. There was general recognition that financial institutions play a key role

in ensuring that mining is sustainable and that it equitably benefits citizens of resource-rich countries. Managing the socio-environmental risks also decreases operating risks and liabilities. This can be assisted by recruiting socio-environmental experts with a high level of expertise and knowledge of impacts as well as managing corporate–community relationships. As one financier put it: “It’s cheaper to build a good house from scratch than fix a run-down one.”

Negotiating access to and use of land and water has emerged as a critical issue. Linked to this is the right of indigenous peoples to free prior and informed consent. While this remains contested by some, it is increasingly recognised as necessary to secure a “social licence” to operate. Corruption, and mounting global pressure for greater revenue transparency, through mechanisms such as the Extractive Industry Transparency Initiative, will continue to influence the sustainable mining agenda. These are critical issues, especially in the context of increased Australian mining activity in high-risk, conflict-prone countries.

There was general recognition that effective partnerships are needed to address complex issues and to drive better outcomes for the mining sector, financiers and project-affected people. These partnerships must include direct relationships between project affected people, communities and companies. The early involvement of all stakeholders is essential to a project’s success.

Civil society can play a role in facilitating these partnerships. It was also acknowledged that reformers and “progressive thinkers and innovators” in the industry and in resource-rich, developing countries need to be supported.

Finally, it was agreed that due diligence is a continuous process that can deliver social and environmental protections and reduce risk for mining companies, their financiers and mining affected people. For due diligence to be most effective, it must be based on the principles of transparency of — and accountability for — identified risks and

adverse impacts. Increasingly, banks will encourage their clients to publish third party socio-environmental due diligence.

## Acknowledgements

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## Resources

The ***Sustainable project financing: getting the basics right*** publication, developed for the symposium, is available on the Oxfam Australia website <http://www.oxfam.org.au/explore/mining>

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## Glossary

**OECD** — Organisation for Economic Co-operation and Development

**ESG** — Environmental, social and corporate governance

**EFIC** — Export Finance and Insurance Corporation

**IFC** — International Finance Corporation

**HSAF** — Hydropower Sustainability Assessment Forum