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# Global: Environmental, Social and Governance (ESG) considerations for the mining sector

Increasing reporting obligations and investor expectations



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# Overview

The metals and mining industry has long been a focus for governments, NGOs, industry bodies and wider society concerned by the environmental and social impacts of the extractive sectors. Over recent years, these concerns have led to the introduction of wide-reaching and robust ESG-focused regulations, codes and principles that mining companies are now obliged and expected to observe, requiring enhanced reporting, the introduction of best practice and procedures and, increasingly, the need to demonstrate that ESG considerations are factored into strategic decision-making.

At the same time, institutional and other large investors are taking a greater interest in a company's ESG performance and taking this into account in their investment decisions, in some cases actively excluding from their investment portfolios mining and other extractive companies that do not live up to ESG expectations.

This article provides an overview of certain key considerations for miners with respect to ESG compliance and discusses some practical steps to help companies manage their ESG risks

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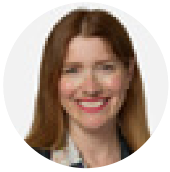

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# In Depth

**ESG - a broad and dynamic definition**

The definition of ESG is broad and dynamic, and can mean different things to different businesses and industries, but in general terms it encompasses such topics as:

- **Environment:** climate change, sustainability, biodiversity, waste, water and resource use, pollution
- **Social:** human rights, labor practices, safety, health, community, diversity
- **Governance:** corporate governance, ethics, shareholder engagement, accountability, compliance and reporting, executive pay, diversity, lobbying, approach to taxation

# Why the heightened focus on ESG?

The increasing volume of regulation and publicized best practice in this area is requiring companies to pay close attention to their ESG behaviors, not only to ensure compliance in the strict legal sense, but also from a strategic and reputational perspective to help them gain competitive advantage and win favor from investors in the market. Indeed, various 'push' and 'pull' factors can be identified as shifting strategic focus to ESG, including:

- **compliance** with mandatory and/or voluntary reporting and legal obligations relating to ESG issues, procedures and standards
- **corporate values**, commitments to deliver on ESG elements of corporate strategy, and a drive to operate ethically, with a clear sense of purpose, and promote more responsible mining practices
- **competitive advantages** in differentiating from peers and securing investment (in particular amidst the rising influence of specialist ESG rating agencies) and facilitating recruitment
- **technical** (including from a health and safety perspective), social, political and reputational risk management, by enhancing community engagement.

# Compliance and reporting obligations and codes

## Key consideration - mandatory obligations

ESG requirements are increasingly evolving from loose guidelines to mandatory international and jurisdiction-specific obligations around ESG reporting and standards. The table below summarizes some of the more significant laws and regulations that mining companies should be aware of (noting a particular focus on applicable UK legislation given the jurisdiction of the authors of this article, but also the leading role that the UK government is taking in this area). However, this is just a sample and it is critical that a company undertakes a thorough review of the relevant domestic and international regulation (which in most cases will be subject to applicability tests) to ensure it is complying with those ESG-related requirements to which it is subject.

| ESG Mandatory Obligations | Overview |
|---|---|
| **The Bribery Act 2010 (UK)** | Establishes a liability regime for both UK and foreign bribery and incorporates requirements set out in the OECD Anti-Bribery Convention and the Extractive Industries Transparency Initiative (EITI). While UK legislation in this area is arguably the strictest, similar legislation in other countries includes:<br>▪ the Foreign Corrupt Practice Act (FCPA) in the United States of America<br>▪ the German Criminal Code in Germany<br>▪ the Prevention and Combating of Corrupt Activities Act, 2004 (PCCAA) in South Africa<br>▪ the United Nations (UN) Convention against Corruption, 2005 (to which most UN Member States are parties). |
| **The Reports on Payments to Governments Regulations 2014** | Brings into UK legislation the EITI standards and implements Chapter 10 of the EU Accounting Directive (2013/34/EU). Applies to UK incorporated companies that are involved in the extractive industry or logging of primary forests and requires disclosure of material payments made to governments in the countries in which they operate in a bid to enhance transparency. |
| **The Companies (Miscellaneous Reporting) Regulations 2018 (UK)** | "Very large" UK companies not already reporting on corporate governance requirements (i.e., excluding UK listed companies themselves, but including their "very large" UK subsidiaries) must include a corporate governance statement in the annual directors' report stating either:<br>▪ which corporate governance code was applied during the preceding year; or<br>▪ why no code was applied and what corporate governance arrangements were in place.<br>In addition, all UK companies that qualify as "large" (including "large" UK subsidiaries) must include a statement in their strategic report describing how the directors have had regard to the matters set out in s 172 *(Duty to promote the success of the Company)* of the Companies Act 2006. |
| **JSE Listing Requirements and Code of Corporate Practices and Conduct (the Code)** | This South African code is similar to the Miscellaneous Reporting Regulations in the UK, although listed companies *must* comply with the JSE Listing Requirements, in contrast with the "comply or explain" regime for listed companies in the UK. |
| **The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018 (UK)** | The Streamlined Energy and Carbon Reporting (SECR) framework requires companies within its scope to provide disclosures on greenhouse gas emissions in their director's reports.<br>North America, Australia and Japan as well as many EU member states also have similar, jurisdiction-specific, greenhouse gas reporting requirements. |

# Compliance and reporting obligations and codes

## Key consideration - mandatory obligations, Continued

| ESG Mandatory Obligations | Overview |
| --- | --- |
| **Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 (UK)** | Climate reporting based on the Task Force on Climate-Related Financial Disclosures (TCFD) is mandatory for companies within its scope for their annual reports for financial years beginning on or after 6 April 2022. |
| **UK Modern Slavery Act 2015** | Combats modern slavery in the UK and requires companies to disclose information on the steps they are taking to ensure modern slavery is not present within their own operations or their supply chain. |
| **ILO Conventions** | The ILO is a United Nations agency that has created eight "fundamental" Conventions covering rights at work, including freedom of association, collective bargaining, elimination of forced labor, abolition of child labor and non-discrimination. Member states are required to ratify such Conventions to create legally binding obligations. As at 1 January 2019, 92% ratification had been achieved, meaning these Conventions are legally binding across the majority of member states. |
| **The EU Emissions Trading Scheme (EU ETS)** | Operates on a "cap & trade" basis, so there is a limit set on the total greenhouse gas emissions that participants (mainly power stations and industrial plants) emit. Participants receive tradeable emissions allowances each year to cover their annual emissions. Those exceeding their quota need to top up their allowances, or reduce their emissions. The scheme is mandatory but there are some exceptions in relation to small installations or plants under a certain size. |
| **Community Development Agreements (CDAs)** | Required by law in some countries (including Australia, China, Nigeria and South Africa), CDAs are contracts between investors and communities through which the benefits of a mining project are shared with communities and other stakeholders. By way of example, in Australia, the Australian Native Title Act requires companies with mining licenses to negotiate and enter into CDAs with Aboriginal communities that have a legal interest in the land as native title holders. |
| **Conflicts Mineral Regulation** | This EU-wide regulation will come into effect on 1 January 2021 with a focus on trade of: tin, tantalum, tungsten and gold. The regulation aims to ensure EU importers of these minerals meet responsible sourcing standards in order to reduce the financing of armed groups, forced labor and other human rights abuses, and limit corruption and money laundering that can be associated with these minerals. |
| **SEC Climate-related Disclosure** | On March 21, 2022, the U.S. Securities and Exchange Commission (SEC) issued its long-awaited proposed rules that, if adopted as currently drafted, would mandate both domestic and foreign registrants to make a variety of climate-related impact and risk disclosures in registration statements and in annual filings under the Securities Exchange Act of 1934. |
| **International Sustainability Standards Board (ISSB)** | The International Financial Reporting Standards (IFRS) are a set of accounting rules widely used for corporate financial statements. IFRS established the ISSB at COP26 to develop a comprehensive global baseline of sustainability disclosures for the capital markets, and has launched a consultation on its first two proposed standards. One sets out general sustainability-related disclosure requirements and the other specifies climate-related disclosure requirements.<br>Consistent with the approach taken for IFRS, it will be for jurisdictional authorities to decide whether to mandate use of ISSB's standards. |

# Compliance and reporting obligations and codes

## Key consideration - mandatory obligations, Continued

| ESG Mandatory Obligations | Overview |
|---|---|
| **London Metals Exchange (LME)** | Metals producers listed on the LME must comply with its responsible sourcing requirements, which are minimum standards and reporting criteria that build on core requirements of the OECD's Due Diligence Guidance for Responsible Supply Chains of Mineral from Conflict-Affected and High-Risk Areas and adopt the OECD five-step framework for risk-based due diligence in the mineral supply chain. |
| **EU Taxonomy** | The Taxonomy is a classification system for organizations to identify which of their economic activities, or the economic activities they invest in, can be deemed 'environmentally sustainable'. The Taxonomy defines environmentally sustainable activities as economic activities that make a substantial contribution to at least one of the EU's environmental objectives, while, at the same time, not significantly harming any of these objectives and meeting minimum social safeguards.<br>All financial market participants, all large companies and listed SMEs businesses will need to report against the Taxonomy.<br>The disclosure requirements began to apply in part on 1 January 2022 |



# Recommendation - mandatory obligations

Mining companies should undertake an analysis of the mandatory laws and regulations in each jurisdiction in which they operate or have entities incorporated, to understand the regulatory framework with which they must comply. Once the scope of compliance requirements is established, a company should prepare and implement a group-wide strategy designed to ensure compliance with the various requirements, through, for example, training, monitoring and reporting. We recommend best practice should include:

- creation, group-wide socialization and implementation of a clear corporate strategy / set of business principles with a focus on ESG
- articulation of a clear purpose explaining why particular ESG aspects are a key focus for the company, as this will enhance engagement of all stakeholders
- appointing ESG expert(s) at board level with ultimate responsibility for ESG compliance matters
- appointing compliance officer(s) with responsibility for ensuring that legal requirements are adhered to and reporting and disclosure standards are met
- establishing clear lines of reporting for company personnel to allow for swift identification of non-compliance or possible issues/concerns and necessary escalation
- provision of resources and training for ESG and other client or investor facing personnel
- monitoring of internal ESG performance at every level of the company, including impact and risk assessments
- enhancement of the due diligence process to include ESG specific measures, particularly when appointing contractors or suppliers.

# Key consideration - voluntary codes and commitments

Many (often overlapping) voluntary codes and principles covering ESG matters have been prepared and publicized by NGOs, industry bodies and other stakeholders, which can make it difficult, particularly for smaller companies, to determine exactly which principles to follow.  New voluntary codes and commitments are increasingly focused on being "Paris aligned" - meaning that it is aligned to limit global warming to 1.5°C compared to preindustrial levels as set out in the Paris Agreement, or being "Net Zero" - meaning that it commits to produce net zero emissions usually by 2050. Some examples of these voluntary standards and commitments include:

| ESG - Voluntary codes | Overview |
|---|---|
| **The Extractive Industries Transparency Initiative (EITI)** | This is an international set of standards, which acts as a tool for countries to improve the management of their oil, gas and mining resources. As noted above, in certain countries, these standards have been reflected in mandatory legislation (including in the UK and other EU Member States). |
| **The Responsible Gold Mining Principles** | Intended to recognize and consolidate existing standards and instruments under a single framework, these principles set out clear expectations for consumers, investors and the downstream gold supply chain as to what constitutes responsible gold mining. |
| **Initiative for Responsible Mining Assurance (IRMA)** | A multi-sector effort to develop a voluntary compliance system for mining operations to independently verify environmental, human rights and social standards. |
| **The UN Guiding Principles on Business and the Human Rights and UN Guiding Principles Reporting Framework** | Among other things, these principles aim to engage extractive companies and help them to understand and manage the impact their activities have on workers and communities located close to their operations. |
| **UN Global Compact (UNGC)** | Ten principles to be incorporated into strategies and policies to enhance cultural integrity and ensure long-term success. The principles focus on human rights, labor, the environment and anti-corruption. |
| **The International Council on Mining & Metals (ICCM) 10 Sustainable Development Principles** | These principles act as a best-practice framework for sustainable development within the mining and metals industry. |
| **Science-based Targets Initiative (SBTi)** | Companies may apply to have their emissions reduction targets validated by SBTi, which certifies that such targets are in line with the Paris Agreement.<br>On 28 October 2021, SBI launched its Net-Zero Standard to provide a credible and independent assessment of corporate net-zero target setting and enable companies to align their near- and long-term climate action with limiting global warming to 1.5°C. |

| ESG - Voluntary codes | Overview |
|---|---|
| **Global Reporting Initiative (GRI) Sustainability Reporting Standards** | Global standards for sustainability which are widely adopted - used by 93% of the world's largest 250 companies. They aim to inspire accountability through the practice of disclosing sustainability performance. |
| **Task Force on Climate-related Financial Disclosures (TCFD)** | Develops recommendations for voluntary climate-related financial disclosures that are consistent and clear, providing lenders, insurers and investors with comparable and reliable information in an effort to make markets more transparent and efficient. As noted above, reporting under this framework is now mandatory for certain UK companies. |
| **The International Council on Mining & Metals (ICCM) Net Zero Commitments** | On 5 October 2021, ICMM members committed to net zero Scope 1 and 2 GHG emissions by 2050 or sooner in line with the ambitions of the Paris Agreement.<br>By 2023, all members will have set Scope 1 and 2 targets, accelerate action on Scope 3, use Paris-aligned methodologies and disclose assumptions, and report progress of Scopes 1-3 emissions annually and in alignment with TCFD recommendations. |
| **Climate Action 100+** | On 9 November 2021, Climate Action 100+ announced its collaboration with eight major mining companies (Anglo American, BHP, Glencore, Rio Tinto, South32, Teck Resources, Vale and Vedanta) to set out a reliable standard for net zero for the mining sector. The standard will align with Climate Action 100+'s Net Zero Company Benchmark and aims to address:<br>▪ Green revenues for mining companies<br>▪ Scope 3 targets and actions across commodity types<br>▪ Target setting aligned with a 1.5°C trajectory for the sector<br>▪ Capital allocation and investments in decarbonization. |
| **Voluntary Schemes in respect of emissions** | There are a number of voluntary schemes, such as the Carbon Trust Standards, the Greenhouse Gas Protocol and CDP (formerly the Carbon Disclosure Project) all aimed at businesses voluntarily disclosing more on their emissions and environmental impact. |



# Recommendation - voluntary codes

We recommend that mining companies consider the voluntary codes applicable in each sector and jurisdiction in which they operate (or have entities incorporated), and identify those that they wish to observe and adhere to. In undertaking that exercise, it is important to be ambitious, while also being realistic in terms of what the company is able to commit to. Compliance with these voluntary standards should then be built into the company's group-wide ESG strategy.  When considering which voluntary codes to subscribe to, it is worth bearing in mind that:

- Certain voluntary codes may become hard obligations in the future, and so may be worth considering now. For example, the EITI principles have and are being implemented into domestic law in a number of countries, and in the UK TCFD-based reporting is mandatory for certain companies.
- Your company may already be complying with certain of the voluntary codes by way of compliance with applicable mandatory codes, in which case it would be possible to sign up to such codes without increasing the overall existing scope of your company's ESG strategy.
- Providing training to suppliers or contractors in relation to your company's ESG policies will assist in compliance with various ESG standards, which focus on the development of the sector as a whole. Consider whether compliance with these standards (in addition to compliance with mandatoryrules) should be incorporated into the company's standard terms and conditions of contracting with its third party suppliers and service providers.
- Different investor groups and other stakeholders may be more focused on certain codes than on others - companies may wish to discuss priorities with key investors before signing up to voluntary codes.

# Investor expectations

## Key consideration - finance providers

As noted above, investors in mining projects (whether debt or equity) are becoming more focused on ESG factors when making investment decisions, which means that, in order to access capital, mining companies will increasingly need to demonstrate a robust commitment to addressing and managing ESG concerns and a record of ESG compliance. While certain ESG-related information will be available from public sources with respect to the larger mining groups who are subject to relevant reporting obligations, there are also indices and ratings agencies (such as FTSE4Good, DJSI, Sustainalytics, MSCI) which rank companies according to their actual or perceived ESG strengths. Larger investors may well also retain in-house ESG specialists responsible for assessing these issues.

A number of institutional investors have now publicly committed to taking ESG factors into account when making investment decisions, such as Hermes EOS and BMO. The Dutch pension fund ABP has stated that "responsible investment is central to our investment philosophy" and similarly Blackrock has stated that "we have integrated ESG considerations across our investment research, portfolio construction and stewardship processes". Prominently, the Norwegian Oil Fund (formally named Norges Bank Investment Management) announced an active exclusion program under which investment prospects may be blacklisted for ESG breaches.

The European Commission's "Action Plan on Sustainable Finance" also aims to reform EU financial services architecture by integrating ESG considerations into policy framework and standards across the finance sector, with the aim of promoting sustainable finance initiatives.

In certain markets (such as London), as well as technical, financial and legal due diligence, the increasing influence of ESG rating agencies has resulted in ESG becoming a key focus in relation to larger mining IPOs. Investor roadshows are fast becoming a platform at which investors can and will pose ESG related questions, including how a company's initiatives align with relevant ESG codes and standards. This means companies that have adopted a more transparent and advanced ESG disclosure framework may be in a better position to attract investors seeking sustainable opportunities.

Alongside the increased equity investor focus on ESG, some lenders are also prescribing particular ESG principles that a company must meet in order to receive funding. This places scrutiny on miners' management plans and how these will assist the company in meeting its key performance indicators (and indeed, the ESG requirements set out by lenders).

For example, the IFC's Environmental and Social Performance Standards define responsibilities that apply to investment and advisory clients going through IFS's initial credit review process and AXA IM have proposed transition bonds which provide an opportunity to finance brown companies with an ambition to transition to green in the future, in industries such as materials, extractives, chemical and transportation.

In addition to informing how investors deploy their capital in the first place, ESG factors have led to a rise in shareholder activism, whereby existing investors use their shareholding to seek to influence the relevant company's ESG performance. In the oil and gas industry, groups such as Follow This have been making themselves known at annual general meetings, often diverting attention from other key strategic messages which boards wish to communicate. We anticipate that the mining industry will soon follow as a target.

## Key consideration - other key factors

Other bodies, including the World Gold Council, are lobbying for insurance providers to become more involved in the ESG movement, in particular by requiring mining companies to uphold ESG principles in order to be eligible for insurance policies.



# Recommendation - investors

In our experience, preparing (and in some cases, publishing) a clear and robust ESG strategy will help to assuage investor concerns regarding the mining industry, and to promote continued investment. Such strategy should carefully consider both the mandatory and voluntary codes set out above (and the extent to which those voluntary codes should apply to a particular company's operations), as well as your company's specific corporate values and overall strategic priorities. It is clearly important to outline how that strategy will be implemented and to demonstrate compliance in practice.

Failing to address ESG concerns at the outset of a project can lead to issues further down the line - we recommend that companies actively engage with investors to pro-actively identify the concerns and explain how they propose to mitigate those ESG risks. Having an open and constructive dialogue not only shows a company's commitment to the ESG agenda but also potentially dampens the ire of activist shareholders in the future in the face of any issues.

# Conclusion

A drive to meet ESG targets and standards should in theory have a positive impact on the mining industry, environmentally, socially and from a reputational perspective. However, as ESG targets rise, so will accountability, and so, while mining companies must strive to be ambitious in delivering against ESG goals, they must also be realistic around what is achievable and build an ESG strategy that works for their individual business to avoid perceived failure and, conversely, a detrimental impact on industry reputation.

In any case, with various factors driving mining companies towards enhanced ESG engagement, not least to stay competitive in the market and attract investor capital (individually and from an industry wide perspective), mining companies must continue to push ESG up the corporate agenda and promote good ESG behaviors from the 'top down'.

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