

**Background – CAFOD’s Concerns:**

CAFOD has highlighted to FairPensions that a series of material ongoing business risks exist for mining groups in instances where there is a failure to gain local community support for mining projects, as well as broader failure to adequately consider the environmental and social impact of both existing and new projects (see appendix 1 for a summary of key business risks). Such risks potentially endanger the viability of projects from the outset and throughout their whole life cycle, and therefore endanger shareholder value.

It is acknowledged that the existence of these risks is generally recognised by leading companies operating within the mining sector (and by a growing number of their institutional shareholders), and that key global mining groups have acted (to varying degrees) to put mitigating policies in place to address these risks.

CAFOD, however, is concerned that many of these policies themselves can be deficient, and where appropriate policies are in place, they may still suffer from inadequate or ineffective implementation. This creates a very real risk of value destruction or failure to maximise potential value for investors. Concern is further heightened by current industry and market dynamics – the importance of continued access to non-renewable ore reserves in a world of progressively fewer unexploited mineral deposits, accelerating industry consolidation, and unprecedented price levels for many key metals is driving a new wave of exploration, and heightening the potential pressures that lead to dislocations between policy and implementation on the ground.<sup>1</sup> - “to step up supply we are challenged to develop resources that in the past were either considered to be too complex, or low grade, or in regions with high country risks and poor infrastructure”<sup>2</sup>

Such concerns have led CAFOD to seek assurance that when investing in mining groups:

1. Pension funds and their fund managers are taking appropriate steps in their corporate due diligence, risk analysis and ongoing engagement to adequately address issues of community support and social / environmental impact (in line with their fiduciary duty). This includes ensuring that the mining companies in which they invest have policies and practices in place which are actually being implemented, to minimise the identified business risks (this would include implementation by joint venture partners / sub-contractors.)

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<sup>1</sup> Amongst other impacts these factors have driven increased exploration in areas previously deemed un-exploitable, often in conflict zones, and frequently in joint ventures with junior industry partners, unaware of or unequipped / unwilling to subscribe to their senior partners’ policies of conduct. A corollary is also the fact of heightening concern by civil society in both host and home countries.

<sup>2</sup> Tom Albanese, Chief Executive Rio Tinto, PDAC Annual Convention, 5<sup>th</sup> March 2008, Toronto, Canada.

2. Pension funds and their fund managers are able to demonstrate to their end beneficiaries that the steps in 1 above are being fully undertaken, and so provide their investors with tangible reassurance to allay any concerns relating to their investments. This would include evidence that pension fund / fund managers' due diligence processes are robust, and that they are receiving sufficient information from mining groups regarding their policies and implementation to enable informed decisions on potential risks and the appropriate level of engagement that may be required to address them.
3. In order to receive the appropriate reassurance, CAFOD believes that pension funds and fund managers should be able to answer the following key questions:
  - a) Has the pension fund / fund manager informed itself of the mining company's existing policies and practices regarding mitigation of environmental and social impacts of projects, and risks arising from potential or actual community opposition?
  - b) If so, do such policies and practices adequately address the identified business risks?
  - c) Is there evidence that such policies and practices are actually being implemented?
  - d) If the pension fund / fund manager is not satisfied re b) and c), is it engaging with the company seeking to remedy this?

## Appendix

### a) Summary Risks of Community Opposition

**1. Financing Risks:** Community opposition can make it more difficult to attract equity financiers or co-sponsors for projects, as investors and financiers may delay involvement, require greater compensation for additional risks, or simply decline to participate at all. If project loan finance is involved, community opposition may delay or prevent its credit approval within banks. Delays in construction could lead to a failed ability to access project finance fully, and ongoing operational difficulties post construction, due to community opposition, could trigger covenant defaults under loan agreements / demands for accelerated loan repayments.

**2. Construction Risks:** Blockades, work stoppages, and lawsuits can cause lengthy delays in the design, siting, permitting, and construction of the project, and can significantly raise the costs of construction.

**3. Operational Risks:** Community opposition can increase the risks that the project sponsor will not be able to produce a sufficient quantity of output, or sell it at a sufficient price, to justify the investment. Community conflict can also force the company to incur additional costs to secure its facilities, and develop and implement politically acceptable post-hoc environmental and social mitigation plans.

**4. Corporate Risks:** Reduced profitability and asset values of a project can decrease a company's stock valuation, particularly for less-diversified companies. In addition, the perception that a company cannot earn the support of host communities can adversely affect its ability to raise financing for future projects, or to negotiate acceptable terms and premiums for project insurance.

**5. Host Government Risks:** In response to local concerns, a host government may commence enforcement actions or impose civil or criminal penalties on sponsors, tighten regulatory or statutory requirements, or withhold or withdraw necessary permits and licenses. It may even void its commercial arrangements, withhold payments, or nationalise private assets.

**6. Host Country Political Risks:** Similar grievances in different communities in a country or region can accumulate to the point where the business environment for a company or industry is degraded.

**7. Reputation Risks:** Mining companies that develop a reputation as being coercive, predatory and indifferent to social concerns in one location may find that other communities become much less willing to host its projects.

**8. Home Country Political Risks:** Reputational risks can develop further into growing calls in a company's country of incorporation for a tightening of legislation, to enable regulation of a company's overseas operations, irrespective of the relevant host government's willingness or ability to regulate the operations of local subsidiaries.

**b) Summary Risks from failing to properly analyse and manage environmental and social factors:**

**1. Financing Risks:** Project financiers and investors are increasingly expecting rigorous environmental and social due diligence and robust risk management systems as a condition of support.

**2. Construction and Operational Risks:** Post hoc remediation of environmental and social problems can result in construction delays and disruptions in operations, and can be much more expensive than impact avoidance, minimization or mitigation.

**3. Conflict Risks:** Adverse environmental and social impacts can lead to community opposition and forfeit the company's 'social licence' to operate and precipitate the risks outlined under the "Risks of Community Opposition" above.

**4. Corporate Risks:** Financiers and investors increasingly consider management's ability to recognise and manage environmental and social issues as indicative of their overall competence and vision. Accordingly, companies that are not sufficiently alert to these risks or proactive in managing them may lose the confidence of their lenders and shareholders.

**5. Host Government Risks:** In response to environmental and social problems, a host government may commence enforcement actions or impose civil or criminal penalties on sponsors, tighten regulatory or statutory requirements, or withhold or withdraw necessary permits and licences. It may even void its commercial arrangements, withhold payments, or nationalise private assets.

**6. Reputation Risks:** Mining companies that develop a reputation as being inattentive to environmental and social risks in one location may find that other communities become much less willing to host its projects.

**7. Litigation Risks:** Mining companies that cause serious environmental and social harms may be sued in host country, or potentially home country courts. These cases are invariably costly, time-consuming, and extremely damaging to the company's reputation

**8. Home Country Political Risks**

Reputational risks can develop further into growing calls in a company's country of incorporation for a tightening of legislation, to enable regulation of a company's overseas operations, irrespective of the relevant host government's willingness or ability to regulate the operations of local subsidiaries.