ESG investor demands in the mining sector continue to rise

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Investors in mining projects (whether debt or equity) are increasingly focused on environmental, social and governance (ESG) factors when making investment decisions. This is unsurprising given that according to a review undertaken by PwC - *Mine 2021: Great expectations, seizing tomorrow* - those miners with better ESG ratings have delivered, on average, 10% higher shareholder returns than the wider market in recent years.

Source: Jose Luis Stephens © 123RF.com

This means that in order to access meaningful capital, mining companies will increasingly need to demonstrate a robust commitment to addressing and managing ESG risks and concerns, as well as a strong track record of ESG compliance.

From an investor perspective, the global focus on climate change and path to net zero has inevitably shone a spotlight on the "E" aspect of ESG, encompassing issues such decarbonisation, waste and water management, air and noise pollution and biodiversity loss. For example, according to a recent Accenture report - *Mining's new role as a champion of decarbonization* - 63% of investors in mining and metals would be willing to divest or not invest in those companies which fall short of decarbonisation targets.

However, issues and identification of key risks related to the “S” and “G” aspects are also of material importance in guiding investment decisions, particularly in the context of a miner’s relationship with regulators, NGOs and local communities, all of which underpin its ‘licence to operate’ and ability to deliver on projects.

Investor demands

The Global Sustainable Investment Alliance states in its most recent report - *Global Sustainable Investment Review 2020* (July 2021) - that, at the time of publication, sustainable investment assets comprised 35.9% of total assets under management. This trend is expected to continue upwards, with many investment managers moving from ESG integration screening strategies (requiring a review of ESG factors as part of their overall investment analysis) towards negative screening strategies (whereby companies which do not uphold specific ESG principles would be prima facie excluded from a manager’s portfolio).

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”.

Taking this one step further, certain investment funds (for example, the Norwegian Oil Fund) have announced that they will actively exclude investment prospects that are the subject of ESG non-compliance.

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3 Feb 2023

Landers prescribing ESG principles

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

Similarly, the International Financial Corporation’s (IFC) Environmental and Social Performance Standards define standards 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, chemicals and transportation.

In certain markets (such as London), as well as technical, financial and legal due diligence, the influence of ESG rating agencies has resulted in ESG becoming a major 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.

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.

Shareholder and other activism

In addition to informing how investors deploy their capital in the first place, ESG factors have become a feature of 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. For example, the shareholders of BHP Group submitted resolutions in 2022 regarding climate sensitivity analysis in financial statements, and advocated for BHP to deliver a consistent climate policy.

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.

Recommendations

The mining sector continues to attract investment, including from those investors focused on ESG and in particular sustainability, not least because of its key role in facilitating the accelerating energy transition (something which has not always been well understood by the wider investment community).

In our experience, preparing (and in some cases, publishing) a clear, robust and deliverable ESG strategy will help to assuage investor concerns regarding the mining industry, and to promote continued investment. Such a strategy should carefully consider both the mandatory and voluntary ESG frameworks and standards (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, monitor and record compliance in practice.

It is also possible for miners to obtain independent certification of their ESG performance from bodies such as the International Council for Mining and Metals (ICMM) or Initiative for Responsible Mining Assurance (IRMA) which evaluate performance against industry accepted ESG (e.g., IFC). The independent nature of the assessment (depending on the outcome) can provide welcome assurance for potential investors looking for sustainable investment targets.

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 proactively identify ESG concerns from the start and explain how they propose to mitigate or eliminate 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 face of any future challenge.

Looking ahead

From a board perspective, the "G" aspect of ESG is growing in prominence. Litigation risks arising from potential parent company responsibility for subsidiary actions (or inactions) in the ESG sphere are increasing. In addition, the volume and remit of required ESG reporting is growing in many key jurisdictions, generating greater compliance obligations and opening a window for activists to seek to hold companies to account for upholding the ESG claims they make.

We anticipate that it will not be long before most investors expressly include corporate governance and verification of claims made in ESG reporting exercises within their investment assessment processes.

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