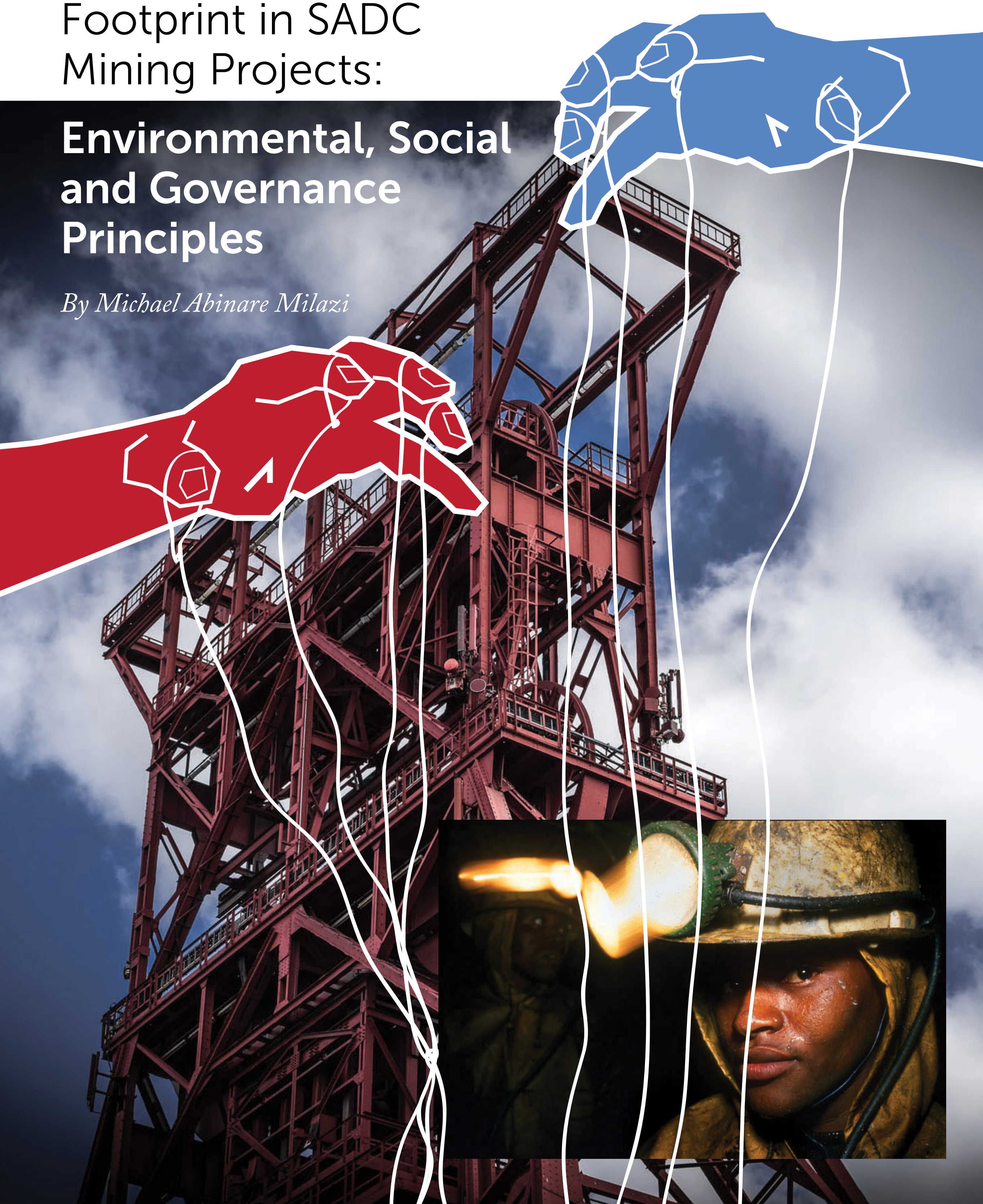
South African Banks Footprint in SADC Mining Projects:

Environmental, Social and Governance Principles

By Michael Abinare Milazi



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By Michael Abinare Milazi

About the author

Michael Abinare Milazi is the director of Ideal Future Research and Consulting. This company provides research and advisory services on legal, political and financial matters to public and private sector entities in South Africa and on the African continent. He has previously worked as director of Financial Services at the National Treasury of South Africa as well as lecturer at the University of the Witwatersrand, Business School. Michael holds a Masters of Law (LLM) from Columbia University, USA; a Bachelor of Laws from the University of Witwatersrand, South Africa; and a Bachelor of Arts from the University of North Carolina, USA.

Contents:

Foreword

Southern Africa is home to significant deposits of some of the world's most strategic minerals, such as platinum, manganese, chromium, cobalt, titanium, diamonds, copper and gold. The tapping of these minerals often requires millions of dollars to be spent on exploration, new technology, roads railways and ports to mention just a few. The role of banks in funding mining operations cannot be overemphasised especially since the mining sector is considered risky and expensive. South Africa is one of the foremost mining countries in the world. South African mining companies, big and small are mining copper and gold in the Democratic Republic of Congo (DRC), copper in Zambia, platinum in Zimbabwe, gas in Mozambique, coal in Swaziland, and diamonds in Botswana and Namibia.

South African Banks are often key funders of a number of mining companies. Questions abound on the nature of these deals and the lack of transparency that surrounds them. There are concerns about whether banks do due diligence before they fund any mining activities to guide against corruption, social, environmental and human rights abuses that are linked to mining. This report interrogates the funding commitments of South African banks in mining in SADC and considers whether they can do things differently. The research analyses international norms, guidelines and assesses how South African banks are implementing them.

Most mining companies approach banks for loans to fund their mining projects. Banks are required to undertake due diligence on their potential clients before they can fund them to ascertain their corporate social responsibility and corporate governance levels. Mining in general tends to have negative impacts on both humans and the environment around the area it takes place. This places a huge responsibility on the whole business chain from lending to final delivery of projects. Banks, therefore, can have a strong influence on companies' behaviour since they are involved from an early stage in funding projects. Banks can condition their funding to best corporate behaviour by ensuring that companies that receive funding have a strong business and human rights approach. Banks need to have the necessary capacity to undertake risk analysis, not only concerning financial but environmental and social risks.

The OSISA strategy on natural resource governance is one that is driven by the belief that mineral resources will contribute to development only if extraction is done in a transparent and accountable manner along the entire value chain. Social and environmental accountability are also critical aspects of this strategy hence the importance of this project. Our hope is that this report contributes to building a body of knowledge that can enrich discussions on pushing banks in southern Africa to consider a mining funding model that promotes human rights, community empowerment, transparency, and environmental protection.

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List of acronyms

AU	African Union
BASA	Banking Association of South Africa
BSD	Bank Supervision Department of the SARB
CKGR	Central Kgalagadi Game Reserve
CoAL	Coal of Africa Limited
CPA	Consumer Protection Act of 2008
CRA	credit ratings agency
CRISA	Code for Responsible Investment in South Africa
DMR	Department of Mineral Resources
DRC	Democratic Republic of Congo
DWA	Department of Water Affairs
EIA	environmental impact assessment
EP	Equator Principles
EPA	Equator Principles Association
FATF	Financial Action Task Force
FICA	Financial Intelligence Centre Act
FSB	Financial Services Board
FSC	Financial Services Council
EIA	environmental impact assessment
ESG	environmental, social, and governance (principles)
GDP	gross domestic product
GEPF	Government Employees Pension Fund
GRI	Global Reporting Initiative
IFC	International Finance Corporation
IRAS	Institute of Reporting and Sustainability
KCC	Kamoto Copper Company
KCM	Konkola Copper Mines (Zambia)

MIASA	Mining Industry Association of Southern Africa
MPRDA	Mineral and Petroleum Resources Development Act
NCA	National Credit Act of 2005
NCR	National Credit Regulator
NGO	non-governmental organisation
PAIA	Promotion of Access to Information Act No. 2 of 2000
PLC	public listed company
SADC	Southern African Development Community
SAPS	South African Police Service
SARB	South African Reserve Bank
SLP	social and labour plan
SRI	socially responsible investment
SDTI	Sustainability Data Transparency Index
UN	United Nations
UNEP	United Nations Environment Programme
UNPRI	UN Principles for Responsible Investment
US	United States
WEF	World Economic Forum
WHO	World Health Organization
WUL	water use licence

Introduction

Environmental, social and governance (ESG) concerns are an increasingly important factor worldwide for banks when they invest in large projects. In the Southern African region with its rich mineral deposits, this trend has added importance. Mining companies extract minerals from the ground, and their activities routinely give rise to public concerns about the pollution of water sources, adequate land for agriculture, and fair community participation in mining projects. South African law accepts that the directors of corporations such as banks have fiduciary obligations to act in the best interests of shareholders.[1] Given the importance of mining activity to economies in Southern Africa an important question aligned to this fiduciary duty is this: Are banks when conducting business obliged to act in the best interests of stakeholders affected by the activities of the mining companies they fund? The trite response is that banks have recognised their obligations to communities through their commitment to SRI (socially responsible investment) practices and internal ESG processes that ensure that their funding decisions result in no harm to communities.

The cost of negative publicity associated with being identified as a bank that provides funds to mining companies that violate human rights in host countries is great, particularly for banks that are publicly listed on bourses. This reputational risk is a genuine concern for banks, and can affect their ability to generate returns for holders of company shares and bonds. Therefore, in the free-market economies of Southern Africa, where markets punish firms for making bad decisions, investing in processes to protect the reputation of a bank from associations with human rights violations can be viewed as a good decision. Adhering to ESG principles and SRI practices is a prudent strategy that protects banks, showing that these institutions do not act in ways that harm the societies in which they make their profits. With the increased attention given to implementation of ESG principles in the financial sector, questions regarding the effectiveness of these principles routinely arise. Do the guidance and internal processes of banks achieve what is displayed in annual reports and sustainability reports? The answer to such questions is not simple for a number of reasons. Chief among these are inequalities between mining companies and communities regarding the financial resources available to each to present their perspectives. There are also differences in access to the types of forums where each can communicate the effects of mining activities. Furthermore, vast differences exist in the skills deployed by banks, mining companies and communities as they evaluate rules-based ESG procedures that regulate bank conduct in funding mining projects.

This paper sets out to critically consider the effectiveness of ESG principles implemented by

[1] This duty exists in common law but has been codified in South Africa by the Companies Act no. 71 of 2008, specifically in the provisions of section 76 that deals with the standards of a director's conduct.

South Africa's banks when they fund mining projects in the SADC region.[2] There are internal differences in ESG principles between banks, and a variety of funding methods to which the principles are applied. The study evaluates the ESG frameworks used by each bank and, given the significant market share, aggregates this information to present a picture of the effectiveness of these frameworks. The approach taken is a critical one, meaning that what is presented in bank annual reports and sustainability reports is not merely accepted, but (to the extent possible) internal ESG risk frameworks are interrogated for adequacy of application by banks when funding mining projects. The effectiveness of the implementation of internal ESG procedures by banks is then measured against available evidence. This evidence includes the effects of mine project funding decisions of banks on ESG categories as ascertained from public information. After consideration of the evidence, observations and conclusions are provided on the analysis. In the closing section, recommendations are provided on areas for possible focus to improve the effectiveness of ESG principles used by banks in the SADC region.

[2] The Southern Africa Development Community (SADC) is a formal regional grouping of countries within a defined geographical area of Southern Africa, comprising 15 countries, and with a secretariat and headquarters in the capital city of Botswana (Gaborone).

Chapter 1:

Mining in the SADC Region and Environmental, Social and Governance Principles

The Southern African Development Community (SADC) is a treaty-based community of states whose objective is to realise the integration and co-ordinated development of its 15 member states located in Southern Africa.[3] The discovery of large mineral deposits at the turn of the Twentieth Century in the Kimberley diamond fields and gold-bearing reef on the Witwatersrand led to an influx of international capital from the United States and United Kingdom and the development of a significant mining industry in South Africa.[4] The subsequent discovery of minerals (such as diamonds in Botswana and Angola, platinum and uranium in Zimbabwe and Namibia) has meant that, with few exceptions, SADC member states have developed mining sectors that contribute significantly to national economies. The minerals extracted in Southern Africa are diverse and are sold globally, providing important foreign exchange payments to SADC governments. The importance of mining to the region's economy is evident from the establishment of regional bodies and compacts such as the Mining Industry Association of Southern Africa (MIASA) and the SADC Protocol on Mining, signed in 1997.

An overview of the mining industry in several countries in SADC highlights the continuing importance of the sector to the national economies of the region.

[3] The members of SADC are Angola, Botswana, Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe http://www.sadc.int/member-states/ accessed 15 January 2016.

[4] *Chris Noon"New Mining Target' Anglo-American Forbes Magazine. 21/8/2006*

Table 1. Overview of mining sector in the SADC region

Country	Mining Sector
Botswana	Accounts for 22.4% of GDP and more than 50% of government revenues. October 2015 exports of around P4.6 bn, of which 87.3% is attributed to the export of diamonds.
Democratic Republic of Congo (DRC)	Mining makes up around 20% of GDP. In 2013, more than US$1 bn in direct payments made to the state by 105 DRC mining companies. Minerals include gold, diamonds, copper and cobalt.
Namibia	Direct contribution of 11.6% to GDP. Generated revenue of N$21.6 bn. Significant employer at 7903 permanent employees and 8920 contractors. Minerals include diamonds and uranium.
South Africa	Accounts for 8.3% of GDP, 19.4% of private sector investment, and 12.2% of total investment in the country. Mineral sales in 2013 amounted to R384.9 bn. Minerals include gold, chrome, iron ore and platinum.
Tanzania	Mining contributes 2.8% of GDP. 40 tonnes of gold per year, and 2890 tonnes of copper. Estimated value of the sector is US$ 1.28 bn. Minerals include copper, diamonds, tanzanite, cobalt and gold.
Zambia	6.6% of the world's copper reserves and 60% of total country exports.
Zimbabwe	Mining contributes 4.3% of GDP and employs 7% of the workforce. Over 40 types of minerals are mined including gold, chrome, coal, platinum and diamonds.

The banking sector in South Africa

The South African banking sector is well regarded internationally, and is the most highly advanced on the African continent. The sector was ranked sixth out of 144 countries in the 2014-2015 World Economic Forum Global Competitiveness Report for the categories of the availability of financial services[5] and the soundness of the country's banks.[6]

The sector is regulated by the Registrar of Banks and the Bank Supervision Department (BSD) of the South African Reserve Bank (SARB) under authority sourced from the Banks Act no. 94 of 1990. There are 17 registered banks, two mutual banks, 14 local branches of foreign banks, two cooperative banks and 39 foreign banks with approved local representative offices in the country's banking sector.[7] The Banking Association of South Africa (BASA) is an industry body that represents all banks registered and operating in South Africa, including local and international

[5] World Economic Forum (WEF) Global Competitiveness Report 2014-2015. p497

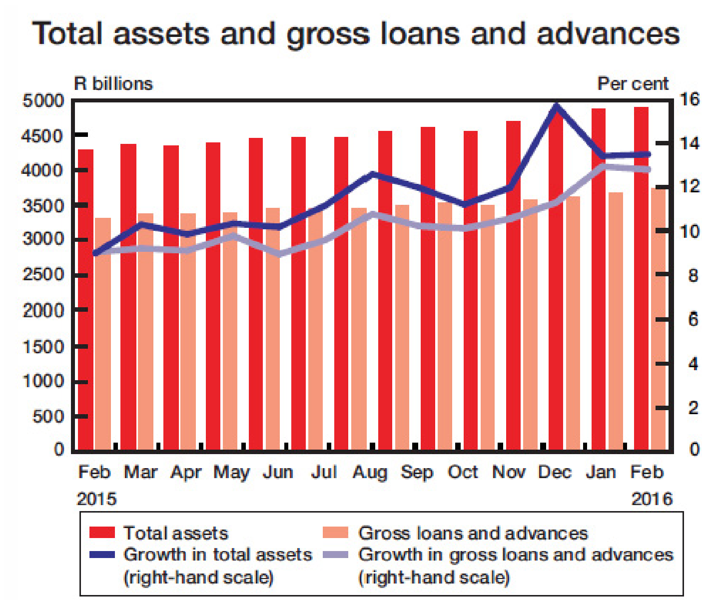
[6] Ibid. p501

[7] South African Reserve Bank publications: Selected South African banking sector trends, February 2016

banks. The association has a wide mandate, which includes lobbying, policy influence, and engaging with critical stakeholders.[8] BASA has established a Sustainable Finance Committee composed of member banks and other stakeholders, which is concerned with the provision of financial capital and risk management products and services in ways that promote or do not harm economic prosperity, the ecology and community well-being.[9]

The monetary value of assets held by South African banks is significant. Total assets of the industry were R4274 bn in 2015, increasing to R4893 bn in 2016, representing growth of 14.5 percent.[10] The sector plays an important role in supporting economic activity in South Africa's economy, and the value of gross loans and advances increased from R3304 bn in 2015 to R3726 bn in 2016, representing growth of 12.6 percent.[11] The four major banks (Standard Bank, Nedbank, FirstRand Bank and Absa Bank) in combination with the newer entrant in the sector, Capitec Bank, represented about 90 per cent of total banking assets in South Africa in 2014.[12] The four major banks have investment banking divisions, who along with specialist bank Investec Bank are active in the funding of mining projects in SADC.

Graph 1: South African banking sector: Total assets, gross loans and advances



Source: SARB, Banking Supervision Department. 2015

[8] http://www.banking.org.za/about-us/association-overview accessed 24/04/2016

[9] http://www.banking.org.za/about-us/committees/sustainable-finance-committee accessed 24/04/2016

[10] Ibid.

[11] Ibid.

[12] Ernst and Young Sub-Saharan Africa Banking Review 2014 Calendar Year. p18

Origins of environmental, social and governance principles

The concept of environment, social and governance (ESG) principles has its origins in the 1970s, when large corporations playing a major role in western economies developed philanthropy and community affairs programmes, and thereafter began issuing reports about these involvements.[13] ESG now consists of specific principles that have evolved significantly from those early beginnings. During the 1970s "ethical investing" (as it was called) emerged, and as a practice this involved "negative screening". This meant that large western corporates began avoiding investment in companies that produced products that were ethically objectionable to their funders or investors. As a consequence, specific industries such as tobacco or gambling were increasingly avoided as investments. Added impetus in developing ESG would come in the next decade. During the 1980s the Bhopal Gas disaster in India, the Chernobyl nuclear plant incident in Russia, and the Exxon Valdez oil spill in the United States led to increased concern about environmental damage caused by oil and gas companies that resulted in the passage of laws that allowed for the specific release of data by companies.[14] In addition, the pressure of the international economic sanctions movement against the minority apartheid government of South Africa led many US companies to actively screen investments to South Africa in the 1980s.

In the 1990s, the trajectory towards the development of ESG principles was influenced by the need for more systemic capture and reporting of data related to sustainability issues. The imperative for data, among other things, resulted in the creation of the Global Reporting Initiative (GRI) in 1997[15] and the UN Global Compact in 1999.[16] ESG in the global financial sector is identified by its specific content, distinguishable from germane terms used in sustainability finance. Ethical investment, for example, is seen as a broad term describing efforts by companies to incorporate values into investment. Socially Responsible Investing (SRI) includes actions by companies that attempt to have a positive impact on society using their capital. ESG in the financial sector is defined as the incorporation by companies of non-financial aspects relating to three defined categories when making investment decisions.[17]

[13] Lydenburg, Steve Global Corporate Governance Forum Issue number 32. Emerging Trends in Environmental, Social and Governance Data and Disclosures: Opportunities and Challenges.p4

[14] Ibid.

[15] https://www.globalreporting.org/information/about-gri/gri-history/Pages/GRI's%20history.aspx. Accessed 28/04/2016

[16] resPACT Austria News Bulletin: Summer. July 2006. p1

[17] FT Special Report 10 February 2014

The range of issues included in the three categories of ESG is diverse and is presented below:

Environmental Social and Governance (ESG) Principles		
Environmental	**Social**	**Governance**
• Fresh water use and discharged water use and impacts on aquatic ecosystems • Mine waste management • Artisinal mining issues • Biodiversity impacts resulting from mining activity	• Mine closure impacts • Impact of mining on local livelihoods, agriculture and farmland • Fair labour practices • Provision of adequate housing for migrant workers and families • Health issues, including TB, HIV and lung silicosis	• Corruption and bribery • Transparency of payments to host governments • Human rights, e.g Kimberley Process, conflict minerals • Local procurement

ESG principles in South Africa's financial sector

The Code of Banking Practice established by BASA came into effect on 1 January 2012. Much like ESG principles, the code is a normative set of provisions that acknowledge the ability of banks to inflict harm on society in the conduct of business. Under the code, banks must conduct business in a fair, transparent and accountable manner.[18] The code, however, is voluntary.[19] It also cannot objectively be included within the universe of ESG as its principles are narrow, applying only to personal and small business customers of South African banks.[20] South Africa's banking and broader financial sector, maintains three formal codes that qualify to be called ESG principles in the manner that the concept is currently understood. The codes are: (1) CRISA (the Code for Responsible Investment in South Africa), (2) the UNPRI (United Nations Principles for Responsible Investment) and (3) the Equator Principles (EP). These codes provide the backdrop of industry initiatives in which ESG policy in South Africa's banking and broader financial sector is being implemented.

[18] See the Code of Banking Practices: Banking Association of South Africa
[19] Ibid.
[20] Code of Banking Practices: Principle 3

The United Nations Principles for Responsible Investment (UNPRI)

The UNPRI Initiative is a private investor initiative that was created in partnership with the UN Environment Programme (UNEP) Finance Initiative and the UN Global Compact. The UNPRI are six principles relating to sustainability, currently being implemented by a global network of institutional investors working together as signatories. The principles require signatories to:

- incorporate ESG into investment analysis and decision-making;
- incorporate ESG into ownership policies and practices;
- seek appropriate ESG disclosure from investee companies;
- promote the acceptance and implementation of the standard in the investment industry;
- take joint action to enhance the effectiveness in the implementation of the principles; and
- report on activities and progress towards implementation of the principles.[21]

The six principles are voluntary and apply to insurance companies, pension funds, and asset managers. The twin goals of the UNPRI are to create an understanding of the implications that sustainability portends for institutional investors, and to support the implementation of the principles by signatories. Signatories to the UNPRI in South Africa include the Eskom Pension and Provident Fund, The Government Employees Pension Fund (GEPF), Sanlam Limited, and the Allan Gray Group.[22]

The Code for Responsible Investment in South Africa (CRISA)

CRISA became effective in South Africa on 1 February 2012 and, importantly, does not apply to banks. The code applies to *institutional investors*, which are described as "legal persons or institutions that own and invest in the equity of a company and have obligations in respect of investment analysis, activities and returns to ultimate beneficiaries".[23] The relevant institutions may be pension funds or insurance companies. The term *institution* has been defined to include companies such as asset fund managers and consultants that provide services to insurers and pension firms.[24] Using a framework of five principles, the code provides guidance to institutions on how best to analyse investments and implement activities in a socially responsible manner that ensures that long-term sustainability considerations are taken into account when investments are made. The code is essentially South Africa's version and implementation guide to the UNPRI.

[21] UNPRI Initiative principles
[22] UNPRI Signatory Directory
[23] Definitions: Code for Responsible Investing in South Africa. (CRISA)
[24] Ibid.

CRISA PRINCIPLE	REQUIREMENT
Principle 1	An institutional investor should incorporate sustainability considerations, including ESG, into its investment analysis and investment activities as part of the delivery of superior risk-adjusted returns to the ultimate beneficiaries.
Principle 2	An institutional investor should demonstrate its acceptance of ownership responsibilities in its investment arrangements and investment activities.
Principle 3	Where appropriate, institutional investors should consider a collaborative approach to promote acceptance and implementation of the principles of CRISA and other codes and standards applicable to institutional investors.
Principle 4	An institutional investor should recognise the circumstances and relationships that hold a potential for conflicts of interest and should pro-actively manage these when they occur.
Principle 5	Institutional investors should be transparent about the content of their policies, how the policies are implemented, and how CRISA is applied to enable stakeholders to make informed assessments.

The code has an activist dimension to its prescriptions. It gives guidance on ways institutions can exercise their rights as shareholders to promote sound governance. From a governance perspective, signatories themselves are required to be transparent with regard to their ESG policies, and implementation of CRISA. This is to be done in order to allow external stakeholders to make their own independent assessments on the levels of compliance with the code achieved by signatories.

The Equator Principles (EP)

The Equator Principles (EP) is a risk management framework of ten principles that are used to assess environmental and social risk in large projects. The EP was established by major global banks in 2003 and is based on the IFC (International Finance Corporation) Performance Standards on Environmental and Social Sustainability.[25] The latter establish eight standards that IFC clients are required to meet throughout the life of investments.[26] The Equator principles have currently been adopted by 83 banks in 36 countries.[27] It is the most highly regarded risk management framework for ESG risk among South African banks.[28] In 2010 an unincorporated association the Equator Principles Association (EPA) was

[25] www.ifc.org see the website at Sustainability at the IFC.

[26] International Finance Corporation 1 January 2012 Overview of Performance Standards on Environmental and Social Sustainability at www.ifc.org

[27] http://www.equator-principles.com/index.php/members-reporting. Accessed 26/04/2016

[28] This conclusion was reached from bank responses to questionnaires as part of the study.

formed with a secretariat based in London. The purpose of the EPA is to administer, manage and develop the principles, as well as assisting member institutions to apply the principles.[29] They are applied to projects that use project finance as a funding method and are also subject to application only where projects meet certain thresholds regarding the monetary size of the deal.[30]

THE EQUATOR PRINCIPLES (EP)
Principle 1: Review project and place within a specific category
Principle 2: Conduct environmental and social assessment
Principle 3: Determine the applicable environmental and social standards
Principle 4: Develop an Environmental and Social Management System and EP Action Plan
Principle 5: Demonstrate effective stakeholder engagement
Principle 6: Establish a grievance mechanism as part of Environmental Management System
Principle 7: Independent review of assessment documentation
Principle 8: Include covenants linked to EP compliance in financial documentation
Principle 9: Independent monitoring and reporting of projects
Principle 10: Transparency of processes, reporting on projects to be publicly accessible

Source: Equator Principles, June 2013

Once adopted by banks, the Equator Principles are applied to projects that the bank funds that comply with four criteria:

- Project finance advisory services where total project capital costs are US$10 million or more.
- Project finance with total project capital costs of US$10 million or more.
- Project-related corporate loans (including export finance in the form of buyer credit) where all four of the following criteria are met: (i) The majority of the loan is related to a single project over which the client has effective operational control (either direct or indirect). (Ii) The total aggregate loan amount is at least US$100 million. (iii) The financial institution's individual commitment (before syndication or sell down) is at least US$50 million. (iv) The loan tenor is at least two years.
- Bridge loans with a tenor of less than two years that are intended to be refinanced by project finance or a project-related corporate loan that is anticipated to meet the relevant criteria.

[29] http://www.equator-principles.com/index.php/governance-and-management. Accessed 25/04/2016

[30] See Equator Principles June 2013: Scope

Four of the major South African banks involved in project financing in the SADC region are members of the EPA, while specialist bank, Investec Bank, is not signatory to the principles. However Investec Bank would be familiar with the requirements of the EP from its participation in club funding deals with South Africa banks that are members of the EPA. If the market share of the five major banks is taken into account and their dominance in project finance, the result is that more than 80 percent of the banking sector in South Africa is using the Equator Principles in some form during project finance transactions. Information is publicly available from the association on transactions concluded and compliance levels by the South African member banks. The EPA provides information based on selected reporting periods as determined by the member bank. Readily available information for South African banks covered the 2014-2015 reporting period.

Table 2. EP mining transactions in SADC by South African banks

FIRSTRAND BANK	BARCLAYS BANK PLC	NEDBANK	STANDARD BANK
1 July-30 June 2014 • No reported mining transaction	**2014** • 1 reported mining transaction Liqhobong Diamond mine Lesotho	**2014** • No reported mining transaction	**2014** • No reported mining transaction
1 July 2014 - 30 June 2015 • 1 reported mining transaction Non-SADC	**2015** • No reported mining transaction	**2015** • No reported mining transaction	**2015** • No reported mining transaction

Source: Equator Principles Association: EPFI reporting periods

The EP has been in existence for more than a decade. Barclays Plc is a founding member, and adopted the Equator Principles (EP) in 2003. The first South African bank to adopt the principles was Nedbank in 2005; Standard Bank and FirstRand Bank adopted the Principles in 2009. As with the preceding two ESG frameworks found in the South African financial sector, the adoption of EP by all banks is voluntary. The principles are implemented independently without reference to the secretariat or any institution or standard-setting body of the financial sector. The voluntary nature of the framework means that there are no formal consequences for any misstatements that may be made or the status of being non-compliant in any way.

Chapter 2:

Common Funding Methods for Mining Projects in SADC

In order to assess the effectiveness of ESG principles that South African banks implement in funding mining projects it is useful to consider the project cycle of developing a mine. The potential impact of ESG principles on the ability of mining companies to produce positive sustainability outcomes is great. However, it is a potential that must not be overstated. This is because there are additional players in the South African financial sector who are specialist financiers that fund mining projects and play a role similar to that of banks in the development of mines. The key difference is that these players take on significantly more risk than banks; they provide development funding to mines at an earlier stage in the development cycle of mine projects.

Table 4. Typical mining project cycle and funders

TYPICAL MINING PROJECT CYCLE AND PARTICIPANT FUNDING		
Stage of Development	Type of Funding	Type of Funder
Prospecting	Equity	Shareholders
Advanced exploration	Venture Capital	Specialised Resource funds
Pre-feasibility study	Equity, Venture Capital, Quasi equity	Shareholders, Specialised Resource funds, Selected banks
Bank feasibility study	Equity, Quasi-equity, Debt with recourse	Shareholders, Selected banks, Commercial banks
Construction	Equity, Debt with limited recourse	Shareholders, Selected banks
Post Commissioning	Equity, Debt-non recourse	Shareholders, Selected Banks

Source: Journal of the SAIMM May 2000

Investment banks enter the cycle of mine development at the end of a process that is not widely understood by non-mining stakeholders. The entry point of investment bank funders in the project cycle of a mine is determined primarily by the risk profile of the project which in turn is determined by the conclusions reached in pre-feasibility and bank feasibility studies. It is usually at the point of entry that banks have the ability to impose ESG requirements on mining companies and project developers. As a rule South African banks do not fund new mine projects in the absence of a bank feasibility study. What the project cycle shows is that there are several points in the development of mines where ESG factors can be incorporated, and embedded into the operations. A singular focus on the ESG practices of banks fails to take cognizance of the position of South African banks as the last funders in an established line of funders that invest in new mine projects. These other funders have the opportunity to integrate ESG considerations early on in the development of mines, and the possibility of positively embedding ESG considerations in the early life of mining projects should not become a missed opportunity. This reality has implications for the implementation of ESG principles at later stages by banks.

A list of funding methods most commonly used to fund mining projects by local banks follows. These are methods that incorporate ESG risk-management principles when banks attempt to comply with their sustainability commitments. Each funding method has unique transactional dynamics as a result of structural legal and financial relationships between banks and their mining clients. For example, a specific method may create fiduciary duties between participant banks in a club deal, while another method may involve less onerous disclosure requirements given the sophisticated nature of the class of investor. The common funding methods include:

Project finance

Project finance involves one or more corporate sponsors investing in and owning a single purpose industrial asset through a legally independent project company financed with limited or non-recourse debt. A key feature is that it is founded extensively on a series of legal contracts that unite parties from input suppliers to output purchasers. It can be described as a nexus of contracts that facilitates the sharing of risks, returns and control.

Corporate bond

A corporate bond is a debt security issued by a corporation and is sold to investors. The backing of the bond is usually the payment ability of investors, which is typically money to be earned from future operations. Corporate bonds are a major source of capital for many businesses, along with equity, bank loans and lines of credit. A company needs to have some consistent earnings potential to be able to offer debt securities to the public at a favourable rate. The higher the company's perceived credit quality, the easier it becomes for it to issue debt at low rates and issue higher amounts of debt. Most corporate bonds are taxable with terms of more than one year. Corporate debt that matures in less than one year is typically called "commercial paper".

Private placement

A private placement is a way of raising capital by a company. This is achieved through an offer of securities by a company, to a select group of persons to subscribe its securities.[31]

[31] http://www.psalegal.com/upload/publication/assocFile/ENewslineJanuary2015.pdf accessed 18

The investors are usually large banks, pension funds and insurance companies.

Syndicated loan
A syndicated loan is a loan granted jointly and under common terms by a group of banks to a borrower. The borrower mandates a lead bank to handle the sourcing and aggregation of the lender banks for the syndicate. An arranger finds participant banks that grant the borrower a share of the loan amount. The terms of the loan are negotiated between the arranger and borrower. The primary purpose of the lender is the avoidance of single lender risk exposure. Loan syndication is a complex process with specific agency and re-contracting risks. There are several actors, such as the borrower, arrangers and participant banks.

YEAR 2014

Transaction value (in millions)	Estimated deal	Bank investment advisor
Aquarius Platinum sale of assets to China National Arts and Craft Consortium[32]	US$37m	Rand Merchant Bank (RMB)
Lonmin sale of equity to Bapo Ba Mogale Investments	R664.2m	Standard Bank
Aquarius Platinum sale of assets to Sedibelo Platinum	US$27m	RMB
Exxaro Resources purchase of coal assets from Total Coal SA	US$472m	RMB, Deutsche Bank
Disposal by AngloGold Ashanti of Navachab Gold mine (Namibia) to QKR Corporation	US$ 124.2m	Standard Bank
Royal Bafokeng Platinum private placement	R700m	RMB, Questco, Morgan Stanley
Exxaro Resources sale of New Clydesdale Collier to Universal Coal	R170m[33]	Nedbank Capital, RMB

Source: DealMakers Gold Medal Issue 2014

April 2016

[32] DealMakers Annual issues for 2012, 2013 and 2014 were reviewed to assess the type of mining transactions generally concluded as well as the variety of methods used by South African Investment banks.

[33] Benning.I Bankers' perspective of mining project finance. The Journal of the South African Institute of Mining and Metallurgy, May/June 2000. p152

The table provides a list of some of the mining transactions concluded by major South African banks in the first quarter of 2014. The information selected provides a snapshot of mining corporate, it is generally representative of corporate activity by investment banks and provides insight into the nature of mining funding in the SA banking sector.[34] First, the monetary values of the mining transactions concluded by South African banks are high and frequently meet or exceed the US$10 million thresholds of the Equator Principles. Second, most of the transactions do not make use of project finance, and this includes for key apposite transactions such as brownfields development. Third, there are a variety of methods used to raise capital for mine owners and investors to achieve corporate goals which regularly include asset acquisition and project development. The various funding methods utilised regularly include what could be labelled major deals and are deployed to suit the profile and circumstances of transaction participants.

These factors point to the approach taken by banks to environmental, social and governance issues in mining projects being a function of the internal policy of a sponsor bank rather than external factors such as the Equator Principles or legislative requirements of the country hosting the project.[35] In the past decade statutory provisions that codify ESG type commitments have appeared with increased prominence in the mining laws of several SADC countries (such as Tanzania, and Zambia) where these laws have been redrafted or new versions introduced.[36] The frequency and variety of funding techniques used by South African banks, combined with the low number of mining deals that meet the threshold of Equator Principles point to a situation in the country's banking sector where there is no dominant ESG framework. Stakeholders in SADC region that seek to engage with South African banks on the real-life outcomes of their internal ESG policies will need to seek and locate answers within the banks themselves.

[34] DealMakers Annual issues for 2012, 2013 and 2014 were reviewed to assess the type of mining transactions generally concluded as well as the variety of methods used by South African Investment banks.

[35] Benning.I Bankers' perspective of mining project finance. The Journal of the South African Institute of Mining and Metallurgy, May/June 2000. p152

[36] See section 41(4)(d) of the Tanzania Mining Act of 2010 and sections 52 and 75 of the Mines and Minerals Act of 2015 of Zambia which deal with harmful effects to the environment and human health of persons affected by the operations, as well as provisions on the relocation of communities

Chapter 3:

Decision-Making Processes

This section is concerned with the dynamics of decision-making when South African banks interact with mining companies, and affected stakeholders in mining projects they fund. The purpose of the section is to evaluate key conceptual factors underpinning bank funding of mining transactions in order to highlight the ways in which these factors promote adherence to ESG principles by banks. Funding decisions by banks are not made in a vacuum: there are economic interests, asymmetries in information, risk thresholds and imbalances in negotiating power (among other factors) that influence the conduct of banks in deciding to fund projects. The concepts addressed have their origin in management theory which provides a useful conceptual framework for analysing transactional risk and the more specific issue of ESG risk, which both apply when SA banks fund mining projects.

Transaction dynamics and ESG principles: agency and moral hazard

The methods banks use to fund mining projects are part of management theory and have developed over time to achieve objectives that include efficient risk allocation in project development and capital markets. These methods are utilised within the context of the bank priorities to protect depositor funds, shareholder capital, and minimising risk in the credit extension. At the conceptual level, some of these key dynamics become distinctly relevant when an analysis of bank funding for mining projects is undertaken. These dynamics are useful for highlighting negotiating positions in transactions that take place in an abstract, ideal marketplace. They are discussed in this section through the prism of the economic theory constructs of agency and moral hazard.

Agency

Agency theory in its classic formulation refers to the conflict of interests between shareholders and management of a company. The theory can help external parties understand the internal dynamics of corporations that often contribute to decision-making in banks that leads to the implementation of ESG principles in a manner that does not produce desired outcomes. These problems of agency relate to the delegation of authority from shareholders to professional managers in the running of banks. As a result of delegation, conflicts arise between the objectives of the two groups. There are several factors that influence this conflict that contribute to decisions by bank managers to fund mining projects in a manner that results in non-compliance with ESG principles. These factors include:

- greater rewards accruing to bank management as a result of closing a deal;
- risk attitudes of management differing from those of the bank shareholders;
- time horizon of bank management on contracts being short, with added pressure to produce results in the short-term (i.e. on a quarterly basis).

Managers at banks provided informal accounts about ESG processes that are consistent with agency challenges. Deal originators within banks who previously closed deals purely on the basis of commercial considerations indicated instances of pique where the requirement to conform to ESG principles were enforced in deal approvals. ESG requirements were seen by some managers in the deal approvals process as adding costs and leading to delays in reaching deal close, a more short-term goal. Others saw securing the requisite ESG sign-off that was part of new bank procedures as posing a threat to the ability of the banks to close deals, but this was mitigated by the fact that the processes were increasingly being followed as standard procedure by peer banks providing funding for large transactions.

Agency issues do not only arise in the classic formulation, but are also relevant in the relationship between banks themselves when they participate in club deals where a syndicate of banks provides a loan to a project and different banks are designated as senior or lead arrangers for the loan.

- There may be information asymmetry between senior participants (arrangers) and junior participants.
- Cost inefficiencies: The borrower is monitored by multiple creditors, which creates the possibility of free-riding where the systems of other members of the lending syndicate may not be up to scratch.
- Delegation: Is the monitoring duty of syndicate members delegated to the arranger? And does the arranger act as a syndication agent. The question that arises here is whether the monitoring effort of the agent is accountable to credible interested parties. Absence of delegation creates moral hazard.

If the information provided to participating banks cannot be credibly communicated to the syndicate or verified by it, there's a problem of adverse selection. That means the syndication of loans with less favourable information among other participant banks.

Moral hazard and bank funding

Moral hazard occurs when there is an information asymmetry between two parties to a transaction, and the risk-taking party knows more about its own intentions and consequences of this than the party that endures the consequences. Contracts between mining companies and banks do not, however, follow this pattern. This is because before banks invest in projects they conduct due-diligence exercises and procure as much technical and financial information as possible to mitigate the risks faced by the project. This type of asymmetry, however, captures the position of affected communities in relation to the banks and companies that develop mining projects. It is the banks and mining companies that make the decision about how much risk to take, while communities bear the costs if things go badly. This is a type of moral hazard situation, where the two parties being isolated from the major risks behave differently from how they would if they were fully exposed to the risks of the project in the same manner as the community.

The full consequences of the risks taken imposed on a community require it to deal with possible environmental and health degradation, loss of land-use, and physical harm from lapses in labour standards. Furthermore, the funding processes of banks reinforce these asymmetries with regard to knowledge of material issues. It is only through legislated public processes found in environmental processes that information is provided to affected communities giving them the opportunities to evaluate the potential impact of projects. However, the EIA processes on the part of mining companies and banks are conducted by third-party professionals, and even the public displays of the report do not as a matter of course mean that communities are versed in their implications. It is only where non-governmental organisations have become involved in cases that implicate ESG such as corruption, environmental degradation or forced removals that these information asymmetries have been confronted, and the risk/consequences factor has been more balanced. Competition exists between banks to provide funding for mining projects and to take on the risk identified in professional reports. There exists as well as an established market for the commodities sold from the projects, all of which play a role in which projects the banks will fund even where risk concerns could be construed as passable. Therefore, in the absence of objective, external scrutiny of the reports and decision-making processes for funding, these factors in combination with structural information asymmetries will serve to push banks to fund projects that in the long-term could become controversial or later be discovered to have ESG implications.

Empiricism and sustainability reporting

Banks are able to announce their adherence to well-known ESG Principles and attain the presumption of diligence on ESG issues. Banks can in this way immediately secure reputational benefits associated with principles in the absence of detailed assessments of practices. Without empirical information, it is impossible to determine the objective impact of principles on the conduct of banks. The role that detailed information can play in allowing for objective evaluations of internal practices is not unknown to banks. All the banks that form part of this study are signatories to the Global Reporting Initiative (GRI).

The GRI sees South African banks report on the impact that their activities have across a range of sustainability factors.[37] A local example of the ways in which sustainability reporting can be empirical is found with the Institute of Reporting and Sustainability (IRAS) a private sector company that developed an index, the Sustainability Data Transparency Index (SDTI) using data collected in the areas of the environment, labour standards, health and governance (among others) to allow for direct comparisons to be made between companies of their performance

[37] See IRAS 2015 Research Report at Appendix 1 where the rankings are provided for GRI compliance ratings for companies across a range of sectors.

across a range of areas. A key consideration is the existence of sufficient data that allow for comparisons to be made. While data used in these rankings does not affect the bank-client relationship that is implicated in ESG frameworks, the example provides an indication of the usefulness of empirical data and the importance of transparency. This reporting, however, fundamentally differs from what a data-based reporting regime for ESG should look like in other ways. Sustainability reporting regimes provide for data on the performance of the banks and mining companies across a range of issues such as carbon emissions, environment and labour practices of the banks *themselves*; information related to mining finance practices does not link banks to specific projects and impacts.[38] Consequently, the results of such reporting regimes have an internal focus, primarily concerned with whether banks operate their business in a sustainable manner. This is in contrast to the outward looking evaluations required to assess ESG principles, evaluations that would consider sustainability impacts of banks in a way that does not view them as self-contained entities.

Private profits and public consequences

Credit risk management is concerned with reducing risks faced by private entity banks, when they hold private money in deposits – money in turn that is lent to mainly private clients and governments. Ironically, ESG as a form of risk management is instinctively at odds with the granting of privilege to private arrangements. This is because ESG is concerned with preservation in public matters such as the environment, protection of land, adequate housing, and upholding public health (among other things). The concerns of ESG are public in a way that is not readily compatible with mine project development and profits as currently conceived by the global mining sector. The incorporation of ESG as a component of due-diligence in investment decision-making is filled with tension in relation to the private/public divide that exists between banks and communities affected by bank actions. This divide, is the enduring feature of modern society, but the assumptions underlying the delineation of roles in these realms is increasingly contested terrain.

Banks that fund mining projects maintain that bank-client privilege is the primary reason that information used to establish their compliance with ESG principles cannot be distributed to mining community stakeholders. Should shareholders of the bank require any reports generated as part of compliance, they would be entitled to receive copies under specific conditions. There is no evidence that reports regularly find their way to shareholders and investors. Most information on ESG outcomes is presented to public stakeholders in bank annual reports in summarised form. The information remains protected from independent review and public scrutiny through banks' private ownership rights. The result is that important information is kept away from communities affected by the prescriptions and conclusions of these reports. South African law has determined that commercial confidentiality and privacy of information held by private companies is not

[38] The sustainability reports generally reproduce the information provided by the Equator Principles Association. See for example Standard Bank 2014 GRI Sustainability Report section on ESG risk at p111.

absolute, and such information can be sought under provisions of the Promotion of Access to Information Act No. 2 of 2000 (PAIA) but is subject to limitation under section 36 of the constitution.[39] The case that established this principle dealt with environmental safety issues and public health and the principles established in that case would apply equally to South African banks with regard to privacy of ESG reports and possible requests for information access brought under PAIA.[40] PAIA in the host country of banks, South Africa, has processes that are long and ill-suited to the circumstances of many communities in SADC. The access to information case does in the context of mining finance provide an indication that bank-client relationships will not unquestionably trump concerns that affected parties may have about the practices of mining companies and banks.

The concerns of communities affected by environmental and other harm are, however, matters of a public nature. Currently, there is no independent review of bank policy outcomes, nor space to discuss possible deficiencies in private reports that result in conclusive actions that affect what can be termed public goods (*res publica)*. There is however a deficit in accountability that arises from the absence of any attempt to engage the public on the transgressions against public goods. The presumption in these arrangements is that the public, including those directly affected by funded mining activities, do not need to be informed of the basis upon which monies have been channelled into activities that affect communities. These arrangements require affected stakeholders to believe that banks and third-party service providers will do the right thing.

The privatisation of ESG implementation is compounded by the role of third-party service providers. Banks that fund projects rely on private third-parties for reports on evaluation, monitoring and the verification of environmental and social damage caused by mining projects. The findings of these reports are not independently reviewed, or scrutinised by standard-setting bodies. In the view of banks, it is presumed that communities affected by mining activities do not need to be informed in detail nor reach conclusions about risks they face as a result of projects. In the absence of independent reviews, public stakeholders must accept competence on the part of third-party service-providers. Lastly, communities must assume that these parties have no vested interests in repeat mandates and will always act impartially. The Minister of Environmental Affairs and Tourism of South Africa has in the past taken a decision to uphold an appeal against an authorisation granted on the basis that the environmental consultants utilised for a project did not meet the requirement of independence.[41] Many presumptions underpinning the use of third parties are open to question, as recent global corporate scandals involving failed conduct on the part of providers of professional services shows; scandals that have implicated among others, law firms, credit ratings agencies and accounting firms.[42]

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[39] Trustees for the Time Being of The Biowatch Trust v Registrar: Genetic Resources. 2005(4) SA 111 (T) para 39

[40] Ibid.

[41] International Association for Impact Assessment South Africa Newsletter April 2005 Legal Update p7

[42] Examples include Dewey & LeBoeuf, Enron and the Arthur Andersen scandal and WorldCom scandal.

Chapter 4:

The Effectiveness of ESG Policies

This study has thus far considered a number of issues relating to ESG and South African banks. These include the most prominent ESG standards applied in South Africa, common funding methods that banks apply these standards to, as well as relevant transactional dynamics inherent in bank lending. A key goal of this study is to evaluate the extent to which these banks implement ESG principles when investing in mining projects in SADC. In addition, the outcomes of the evaluation should allow for reaching some conclusions on the effectiveness of the frameworks. As a result of bank-client relationships, detailed information on bank ESG policy implementation and the mining sector remains with banks. To bridge this deficit, meaningful evaluations of these policies can be achieved by the use of public information on bank dealings with mining companies. There is public information on environmental, social and other occurrences in relation to mining activity that help provide a picture of the effectiveness of the ESG policies of banks.

The banks considered in this section are the five major banks in South Africa active in the financing of mining projects in Southern Africa, namely: Investec Bank, ABSA bank/Barclays plc, Standard Bank, Nedbank, and Rand Merchant Bank.[43] The information used in this section was made available by the five banks through their cooperation. A questionnaire was developed and responses sought for the purpose of attaining specific information that is not public, on the internal procedures banks follow when implementing their ESG frameworks. The responses provide a breakdown of individual practice, but also a broad picture of banking sector activity with regards to ESG policy among the majority of the industry. For confidentiality reasons the banks are not linked with individual questionnaire responses. The banks are identified in the table below using alphabetical signification for analysis purposes. The questionnaire was framed as an inquiry into three broad areas of bank activity in ESG: policy and accountability, compliance, and risk mitigation.

[43] Relative to the big four plus one (4+1) banks in South Africa, there exist a number of what can be termed second-tier banks. Most prominent among these is Capitec Bank. However, these are retail banks that do not provide mining finance in SADC, and as a result are not within the scope of this study.

Policy and accountability

Issue	Bank A	Bank B	Bank C	Bank D
Development of ESG framework	In-house with International organisation	In-house with legal and environmental advisors	In-house	In-house
Frequency of policy review	Annual	Annual	Annual	Annual
Parties that complete reviews	In-house and external	In-house	In-house	In-house and external
Location where assessment of project is done	SA	Depends on location of transaction	SA	SA

From the information provided by South African banks, it is clear that ESG policy frameworks are developed internally by banks themselves. The substantive content of these policies is not outsourced to service providers via procurement processes for external development and later delivery to banks. The implication is that ESG frameworks are genuinely owned by banks. The frequency of reviews of policies for their suitability of these frameworks is conducted on an annual basis, which is fairly frequent given that implementation of frameworks happens on an enterprise-wide scale. The annual reviews are primarily conducted using internal personnel, with some banks using a combination of internal and external expertise. All this suggests that significant effort and resources are being put into ESG policies of banks. From a sectoral perspective, there is a high level of uniformity within the practices of the banks, indicating that it is unlikely that banks will enter into counterparty relationships on mining finance transactions where standards applied vary greatly. The assessment of the adequacy of ESG compliance for mining transactions is concluded in South Africa, where ESG policies are developed. It is presumed that ESG policy developed in South Africa will be conveyed and implemented by bank subsidiaries in neighbouring SADC countries. One bank's practice, however, is that ESG compliance assessments are conducted in the country where mining transactions are concluded. From a sectoral perspective the picture that emerges under this heading suggests that South African banks enjoy great uniformity of standards and practices in the design and implementation of their ESG policies which should result in strong cultures of ESG compliance within banks.

Compliance with lending bank ESG requirements by funded mining companies

Action	Bank A	Bank B	Bank C	Bank D
Tracking of Equator Principle compliance in funded mining company by bank	Yes	Yes	Yes	Yes
Frequency of reports on compliance submitted to the bank	Minimum annual	Bank-Annual Clients-18 months	Full monthly	Monthly
Early warning systems in the bank	Yes. Over life of loan.	Yes. Loan	Yes. Loan	Yes. Loan
Bank actions taken with non-compliance with ESG by funded mining company	Engagement and evaluation of loan	Notification to correct within time-frame. No corretion = breach	Short-term review, watch list, remedial action	Assessment & reviews, mitigation, corrective measures

Once mining companies receive funding from the banks, their compliance with internal ESG principles of bank (and, if applicable, the Equator Principles) is tracked through the submission of regular reports on compliance, which is done at the cost of the mining companies. The more common reporting period requires submission of regular monthly reports. The practice in the sector is that a 12-month period is not allowed to pass without the submission of a report. One bank that appears to be the outlier allows clients to go for a period of up to 18 months before a mandatory report needs to be submitted to the bank. This period, however, is sufficiently long enough to allow the client to cause significant ESG harm without remedial action. The requirement to submit reports is supplemented by early warning provisions that all of the banks use. These provisions are embedded in legal contracts that outline the borrowing terms, and where there is failure to disclose occurrences in line with these provisions, there are legal consequences. In the event of non-compliance there are clear steps that all of the banks take to ensure that this is corrected. All banks follow some form of notification, review and evaluation exercise where potential or existing breaches by clients arise. If non-compliance is maintained then breaches are formally declared under loan covenants, which opens up client companies to legal action. In a pattern similar to that dealt with under the policy and accountability, there is significant substantive conformity in the steps that the banks take to ensure that clients remain in compliance with bank ESG principles and their related covenants embedded into loan documentation. What is clear from bank responses is that the system of processes created to achieve compliance with ESG policies is internally consistent. Contractual obligations to disclose material issues of ESG combined with the threat of litigation when breaches occur should presumably act as a deterrent to mine companies that receive bank funds.

Risk mitigation and funding methods

Funding Technique	Bank A	Bank B	Bank C	Bank D
Loan syndication participation	In-house risk mitigation	Client follows strictest standard of participating banks	In-house risk mitigation	In-house risk mitigation
Lead bank on syndication	Negotiates with participating banks	Strictest standard	Freely disseminates information on standards	Deal forum and informal workstreams for syndicate members
Vetting of service providers by other banks allowed	Own vetting, latecomers to syndicate make own choices	Yes	Yes	Yes
ESG for short-term Commercial paper	Yes	Yes	Yes	Yes
Project Finance requires Equator Principles adherence or sign-off by other banks	Yes	Yes	Yes	Yes

The risk mitigation frameworks put in place by banks are, on the face of it, rigorous. Responses to the questionnaire provide evidence that ESG considerations developed internally are integrated into the credit decisions of all the major banks. The assessment of client compliance with ESG is carried out through the use of proprietary software. There is in addition the scrutiny that banks subject each other to when they participate in club funding arrangements such as project finance deals or syndicated loans. In these deals, mining clients would follow internal ESG policies, however one bank would require the client to follow the strictest standard applied by whichever bank is participating in the club deal. Club deals pose a challenge of possible arbitrage on project information and applicable ESG standards. The banks have developed their own different mechanisms to ensure that opportunities for arbitrage are eliminated. One of the banks creates a deal forum and work-streams to flesh out issues material to the specific transaction. Others freely disseminate all material information, while others put issues on the table and negotiate material issues on a bilateral basis with banks participating in the club deal. The BASA Sustainable Finance Committee was also identified by banks as an important forum in which material issues on ESG standards were discussed, and it was indicated that this forum allows the banks, which are frequent counterparties in transactions, to discuss any issues or possible concerns relating to the standards applied by their peers. The examples of procedural scrutiny occur at different times in the assessment process. In some of the banks the greatest scrutiny occurs at the level of a credit committee that has already integrated ESG considerations into preparatory documents for credit decisions. One of the banks has an environmental committee, which functions as an "appellate" referral forum for further scrutiny where possible serious breaches have been flagged during the credit evaluation process. This committee is staffed by bank personnel, but also draws upon third-party, independent specialists who give opinions on issues referred and are given authority to design and propose mitigating measures where environmental concerns have been raised.[44] It is not clear how often resort is had to the heightened procedures, but they are described as forming part of the procedures under the relevant bank's framework.

Responses to the questionnaire indicate that SA banks have put significant effort into the design of internal ESG frameworks and procedures for assessing investments. This conclusion is tempered by limitations regarding the availability of granular information. Other types of information, if available, would allow for greater objectivity on strengths and weaknesses of bank frameworks. The types of information required would describe institutional settings as opposed to information on processes alone. For example, it is not possible to determine the size of the bank teams that work on ESG issues for individual pending or approved mining transactions. Determinations on the variety of skills in teams that work on ESG issues confronting banks during funding would be instructive; the number of issues included under the label of ESG is broad. The presence of bank specialists in the established area of the environment, or banks' access to independent experts on this area, does not mean that banks will retain the ability to adequately evaluate issues relating to non-technical issues such as social obligations, labour, housing, adequate farm land, and other considerations that are fundamental ESG concerns. Banks may subject projects to scrutiny, and still have genuine problems appear later in the project life cycle. Such situations are difficult as there may be no avenues for exit without the bank incurring costs, leading to prolonged support for contentious projects. It is not clear, however, to what extent banks are confronted with contingencies of this kind. There are quantifiable benefits to more information of this kind

[44] These details were provided in an oral interview with an ESG manager at one of the banks participating in the research, and did not form part of written questionnaire response.

reaching the hands of stakeholders. Greater detail would enable stakeholders to form better opinions about the efficacy of the frameworks and enhance public engagement. Governments in the region that may have an interest in the effectiveness of ESG frameworks would also benefit from engagements with companies based on knowledge of institutional facts.

Corporate culture

A more subjective consideration that impacts on the effectiveness of the ESG frameworks adopted by South African banks is corporate culture. From interviews with managers involved in financing of mining transactions but not involved in ESG policy, there were indications that pockets of individual opposition existed in banks that could affect ESG policy outcomes. In one interaction it was stated that credit committee members were not particularly concerned with ESG issues, and that members would not consider availing themselves for engagement on ESG issues. In other encounters it was stated that ESG managers were known as individuals that slowed the progress of deals, or indeed had in the past introduced compliance requirements into well-developed deals that had the effect of sending them back to the drawing board. At another bank, views were expressed on the extent of the research to be conducted and the uses it would be put to. All the banks voiced some degree of concern about the purpose of the research, and the ubiquity of ESG research-related interactions in that produced few tangible results for bank processes. The nature of statements was not categorical, but did reveal that "facts on the ground" may in some instances be inconsistent with the generally progressive institutional narratives of banks on ESG policy.

In mitigation, instances of pockets of retreat from participation should be understood through the prism of ESG making a relatively recent appearance in the South African banking sector. It is a specialist area and is not subject to formal regulatory compliance from the registrar of banks, even as managers know that transgressions in policy can potentially harm the reputation and market valuation of banks.

Chapter 5:

An Analysis of Cases: SA Banks, Mining Projects and ESG Compliance in SADC Countries

An analysis of mining projects in the SADC region using a strict results-based analysis is instructive in reaching some conclusions on the effectiveness of ESG policies in South African banks. The apparent failure to adhere to ESG principles has raised the international profile of several mining projects in the SADC region. The purpose of this analysis is to determine whether there is a funding nexus between South African banks and particular SADC mining projects. A nexus would be a clear commitment from banks that sees financial assistance provided to a mining project using funding methods considered in this study as well as others. Once a nexus is determined, an assessment of public evidence relating to the project and the ESG issues it raises are considered. Conclusions can then be drawn about the effectiveness of the frameworks put in place by banks that made the decision to fund the projects. The purpose of the analysis is to assess the factors relating to ESG in SADC mining projects. The objective catalogue of events at the projects relating to ESG are then looked at in order to determine whether they are implicated by principles, and where this is determined to be the case, an exposition is given discussing the specific context, facts, and factors as they reflect the effectiveness of the internal ESG assessments that would ordinarily be applied to such projects.

Case 1: Ghagoo Diamonds (Botswana)

Country	Botswana
Operation	Ghaghoo diamond mine, Gem Diamonds
ESG issue	Community access to land
Funding	Debt facility
Bank	Nedbank

In 1961, the British colonial government of Botswana established the Central Kgalagadi Game Reserve (CKGR) in the ancestral territory of the Basarwa people. Covering an area of more than 58 000 square km in the centre of the country, the reserve was created to protect the food supply of Basarwa groups that continued to pursue a hunter-gatherer lifestyle[45] and is the largest national game reserve in Botswana.[46] In 1986, the Botswana government announced a decision to relocate the Basarwa community resident in the reserve.[47] The first evictions occurred in 1997 and saw the government relocate some members of the Basarwa community inside the CKGR and others to the settlements of Kaundwane and New!Xade, located outside the CKGR.[48]

In 2000, a national newspaper in Botswana reported that the Minister of Minerals, Energy and Water Affairs had informed a District Council in the Ghanzi region of Botswana that the relocation of the Basarwa from the CKGR was being implemented to pave the way for a proposed diamond mine, which was a controversial media story at the time. Between 1997 and 2002 a series of negotiations took place between the Botswana government and a coalition of local NGOs in order to resolve the relocations contested by the Basarwa, but this engagement failed. In 2002, a second wave of government-enforced evictions from the CKGR took place, and a borehole that was used by the community inside the reserve to secure water was sealed by the government. This action led to a high-profile court case against the government by the Basarwa. The Basarwa stated that they had indicated to the government that they did not wish to be relocated, but that the government had continued to dismantle huts of residents inside the reserve, with reports of police officers being present during the relocations.[49] The official response to allegations that the population inside the reserve was linked to prospecting and potential mining projects was that the allegations were false. The government's stated position was that no decision had been taken to mine anywhere inside the CKGR, and that the only known deposit in the reserve was the Gope deposit which was not considered economically viable.

The narrative regarding which version of events was correct in the dispute between the Botswana government and the Basarwa community became two-dimensional in character, alternating between statements made by Survival International (an NGO based in London) and the Botswana government. A four-year legal battle against the government ensued, and judgement from the High Court of Botswana was handed down in 2006. The High Court in a strongly worded ruling found that the Basarwa community had been wrongfully, forcibly, and without their consent deprived of possession of their land.[50]

In 2014 Nedbank concluded a US$25 million short-term debt facility to Gem Diamonds Limited to complete the construction of the Ghaghoo Diamond Mine. Nedbank Capital acted as the sole

[45] AU Report of the Working Group on Indigenous Communities. Mission to Botswana: 15-23 June 2005. pp12

[46] Ibid. para32. Other national game reserves in Botswana include the Chobe National Park, the Moremi Game Reserve, Okavango Delta Game Park, Nxai Pan National Park and Makgadikgadi Salt Pans National Park .

[47] Ibid.

[48] Ibid.

[49] Sesana, NO v Attorney General of Botswana AHRLR 183 (BwHC 2006)

[50] Ibid. para49

mandated lead arranger for the transaction.[51] In September 2014, Ghaghoo diamond (owned by Gem Diamonds) began operating within the CKGR. Business reports on the mine opening state that the mine is located on the ancestral lands of the Basarwa who were evicted from the area.[52]

Since the opening of the Ghagoo mine, Botswana's Minister of Environmental Affairs and Tourism has expressed doubt in public about "the way (the mine) is set up", asking whether it was worth the trouble. He also stated that the country could not have land degradation for mining as the country needed to be environmentally sensitive.[53]

Section 65 of the Mines and Minerals Act of 2011 of Botswana requires mining companies in that country to conduct their operations in a manner that preserves the natural environment and minimises and controls damage to natural and biological resources. This section is broad enough to include an injunction against mining in a protected game reserve area.

Case 2: Geita Gold (Tanzania)

Country	Tanzania
Operation	Geita Gold mine
ESG issue	Community land removals
Funding	Currency hedging facilities
Bank	Absa

In 2007, in the Northern Tanzanian town of Geita, farmers in the village Mine Mpya village were, growing maize, beans, bananas and other crops on land mostly inherited from their parents.[54] These residents were removed by the Tanzanian government to make way for the development of the Geita Gold mine, owned by Anglo Gold Ashanti.[55] In response to queries regarding the removal of villagers, the company stated that the village lay within the mine's Special Licensed Area.[56] The mine area occupied by the Geita Gold mine is 196 square kilometres.[57] ABSA provided gold hedge facilities to the amount of R90 million to the mine.[58]

Mining projects in Tanzania are governed by the Mining Act of 2010 which has provisions that

[51] 29 January 2014 Nedbank Press Release: Nedbank Capital provides a US$25 million short term debt facility to Gem Diamonds Limited

[52] Faku, D. Business Report: Ghagoo Diamond operation opens in Botswana. 8 September 2014

[53] Ontebebetse, K SundayStandard: TK breaks ranks with the President over CKGR mine. 21 December 2015

[54] http://www.irinnews.org/report/98150/tanzanian-farmers-displaced-mining-live-refugees (accessed 18 March 2016).

[55] Ibid.

[56] Ibid.

[57] http://www.aljazeera.com/indepth/features/2013/05/2013515161130258616.html Local miners left out by Tanzania gold rush. 08 Jun 2013. (accessed 18 March 2016).

[58] http://www.miningweekly.com/article/sa-bank-financing-africas-mines-2002-01-25 (accessed 20 March 2016)

deal directly with community land occupation. A special licence is needed alongside a proposed plan for relocation, resettlement, and compensation of people located in mining areas, which is done in terms of the country's Land Act.[59] Other provisions in the statute state that mineral rights conferred on companies shall be exercised reasonably and shall not be exercised in a manner that *injures* the interests of any owner or occupier of land where mining rights have been extended.[60] The determination of "injury" under most legal systems (including that of Tanzania) would be broad enough to include negative consequences of mining that may affect personal health, environmental damage, and corrupt arrangements depriving occupiers of land compensation.

Case 3: Konkola Copper (Zambia)

Country	Zambia
Operation	Konkola Copper mine
ESG issue	Water pollution
Funding	Term loan facility
Bank	Standard Bank

In July 2015, communities in the four rural villages of Shimulala, Kakosa, Hippo Pool, and Hellen in the Zambian Copperbelt filed a legal suit in the English High Court against Vedanta Resources plc and Konkola Copper Mines (KCM). The communities are situated near the Konkola Copper mines, and in their suit the villagers claim that their water sources and farming land have been poisoned as a result of the copper mining activities of the company.[61]

Vedanta Resources has a term facility loan of US$820 million from Standard Bank for the Konkola mine. The last amount was drawn down in June 2014. A short-term-banking facility of US430 million from Stanbic Bank of South Africa was agreed upon in 2011. The ZCCM Investments Holdings Plc (ZCCM-IH) is a shareholder in the Konkola Copper mine, and its borrowings include a loan of US$27.6 million that is due to Standard Bank South Africa to be repaid with an interest rate of 4.75 percent per annum, payable after 60 months.[62]

The Mines and Minerals Development Act recently passed in the country[63] includes provisions that require mining companies to seek written permission from traditional leadership where mining activity is to be carried out in villages or land of customary tenure.[64] Section 75 of the statute bestows discretionary powers on the Zambian Director of Mines to suspend or shut down mine operations where there is suspicion of transgressions of mining rights or threats to the

59 Section 41(4)(d) of the Mining Act No. 14 of 2010

60 Ibid. section 96

61 Leighday.co.uk/News/August-2015/Zambian-communities-sue-copper-mining-gian-in-Eng accessed 20/04/2016

62 ZCCM-IH Annual Report 2014 . Notes to the Financial Statements p80. Para29(a)

63 Act 11 of 2015

64 Ibid. section 52(1)

environment or health of people in the vicinity of the mining area. The test that is to be used to establish non-compliance by individual mining companies is a reasonableness test.

Case 4: Marikana Platinum (South Africa)

Country	South Africa
Operation	Marikana mine
ESG issue	Housing
Funding	Bilateral Credit facilities
Bank	First Rand, Standard Bank, Investec Bank

The events that occurred in August 2012 at Marikana, the Lonmin-owned platinum mine, represent a dark chapter in the history of South Africa. During a period of 10 days, a total of 44 persons at the mine lost their lives violently; 34 mineworkers lost their lives on a single day after being gunned down by South African police officers during a protracted strike by mineworkers over wage increases. The dominant narrative following the Marikana events has been the effort to grasp the role of interference of prominent South African politicians in the deaths. Following the massacre, the Farlam Commission was set up to investigate the causes of the massacre and the precise sequence of events leading to this occurrence.

Regulatory framework

In South Africa, Lonmin plc (like all mining companies) is required to comply with the Mining Charter. The Charter is an enforceable regulation, a type of industry manifesto that regulates the conduct of licence mining companies with explicit clauses on ESG issues. Sustainable development is described in the charter as the integration of social, economic and environmental factors into the planning, implementation and decision-making of mining projects. Charter objectives include promoting employment and advancing the social and economic welfare of mine communities. Values aligned with ESG principles can be found in various provisions of the charter. Section 2(7) of the charter deals with housing and living conditions; under this section mining companies must implement measures to improve the standard of housing and living conditions for mineworkers.

Section 2(8) deals with sustainable development and growth of the mining industry, which requires companies to implement environmental systems that focus on continuous improvement. There are requirements on health standards, where companies are required to provide management systems to improve all their operations that have a significant impact on the health and safety of employees, contractors, and communities. Mine community development in the charter requires consultation and collaboration with communities prior to the development of mining projects.

Non-compliance with mining regulations is dealt with in the Mineral and Petroleum Resources Development Act (MPRDA). Under Section 98 the submission of inaccurate, incorrect or misleading information in conjunction with any matters raised under the MPRDA is an offence. Section 99 states that persons deemed to have committed an offence are liable to pay penalties. Section 47 of the act states that non-compliance with its provisions by South African mining companies can result in the suspension or cancellation of their permits or permissions. Mining companies are given the opportunity to make representations to the Department of Mineral Resources before adverse regulatory actions are taken.

Findings of the Farlam Commission

After the killing of Marikana mineworkers by the South African Police Service (SAPS) on 16 August 2012, a Commission of Inquiry (the Farlam Commission) was convened. Headed by Judge Ian Farlam, its mandate was to establish the cause of the violence and loss of life and provide a written report to the South African Presidency. The final report, named the Marikana Report, is a public document, and provides details on ESG transgressions by Lonmin plc with regard to its mining licence conditions.

Lonmin plc was obliged to build 5500 homes in the vicinity of the mine for migrant mineworkers as part of its Social and Labour Plan (SLP). These obligations arose as part of the granting of mining rights by the Department of Mineral Regulation under the MPRDA. In the evidence presented in the report, it was established that the SLP required that Lonmin grant its mineworker employees a choice of a number of options (either rental, instalment sale, rent to buy, or full mortgage bond) and allow them to select that which would best suit the individual circumstances of applicant employees. Lonmin annual SLP reports contemplated an obligation to build houses, as opposed to a series of market-driven transactions between employees and property developers, which is what the report concluded had been put in place. According to evidence given in the report, of the 5500 houses that were to be built by the company, only three houses were built.[65] During evidence given during the commission the mining company tried to interpret the nature of its housing commitments in a different manner, but this different interpretation and its related conclusions were not accepted as being correct based on evidence presented during the commission hearings. The report further established that there was a shortage of decent housing in Marikana, and that this shortage was linked to the events that subsequently transpired at the mine. The report found that Lonmin's failure to comply with its housing obligations contributed to the creation of tension and labour unrest.[66] Lonmin had known for years about the squalid conditions that its workers lived in.[67] Lonmin's efforts to address the housing conditions were inconsistent with the terms of the SLP, annual reports, sustainable development reports, and close-out reports submitted after the five-year term of the SLP.

The Mining Charter in South Africa imposes a raft of social obligations on mining companies related to housing, employment schemes, and mine rehabilitation (among other things). The

[65] Marikana Report p527

[66] Ibid. p542

[67] Ibid. p528

events at Marikana where ESG obligations on housing (among other things) were not met contributed to social unrest and the loss of lives. The events were the greatest failing of ESG as the IFC (the originator of the UNPRI and Equator Principles) was a key funder of Lonmin, yet failed to ensure that ESG principles were followed.

There are three South African banks that had provided funding to Lonmin plc's Marikana mine, which falls within the categories of funding considered by this study. Standard Bank, First Rand Bank and Investec Bank provided three bilateral facilities of R660million.[68] Each facility is of a revolving credit nature, consisting of R330 million with a five-year committed component that matures in June 2016, in addition to a R330 million one-year committed component that can be rolled over annually at the discretion of the bank providing the facility.[69]

Case 5: Vele Coal (South Africa)

Country	South Africa
Operation	Vele Colliery, Limpopo
ESG issue	World Heritage, Water pollution
Funding	Debt and Equity funding
Bank	Investec Bank

Limpopo coal is a subsidiary company of Coal of Africa Limited (CoAL) which has been granted permits for a mining area of 8500 ha in the Musina area of Limpopo province, which was supposed to lead to the development of the Vele Colliery. Plans for the mine at one point would see the mine lie seven kilometres from the border of the Mapungubwe National Park. The park is located in an area of significant importance for archaeological, historical and biodiversity reasons. The decision to develop a mine was challenged by a number of non-government actors, which included the World Wide Fund for Nature (South Africa), the University of Pretoria (through its Law Clinic) and the Endangered Wildlife Trust. In addition to the threat posed to the area by the development of a mine, there were a number of administrative matters that were raised in the legal challenge regarding the adherence to proper procedures by the South African government, specifically the Department of Mineral Resources (DMR) and the Department of Water Affairs (DWA) when it issued the mining right for the colliery. The issuance of the water use licence (WUL) was the issue that was the primary subject of the legal challenge by the non-government parties. The latter appealed against the issuance of the licence, as a watercourse that ran through the permitted mining area included a catchment area of the Limpopo River and was a watercourse shared by three countries (Botswana, Zimbabwe and Mozambique) in addition to South Africa. The appeal suspended the operation of the WUL, which however was subsequently lifted by the DWA in October 2011. At the time, there were also amendments made by the

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[68] Lonmin Annual Report 2014. www.Lonmin.com/online_AnnualReport_20141/notes/note_1.8.html (accessed 20 February 2016)

[69] Ibid.

department to the WUL. The non-government actors felt compelled to raise a legal challenge to the granting of the mining right and development of a mine in the location as the developments would have an impact on a number of international commitments by South Africa regarding the treatment and status of the area, given its previously identified importance by the state. These commitments included the World Heritage Convention, the Convention on Biological Diversity, and the SADC Protocol on Mining.

Case 6: Kolwezi Copper (DRC)

Country	Democratic Republic of Congo (DRC)
Project	Kolwezi mine
ESG issue	Water pollution
Funding	Project finance
Bank	Investec Bank

In March 2007, Investec Bank was one of three mandated lead arrangers to arrange and underwrite a total of US$260 million in project financing for the Kamoto Joint Venture which was rehabilitating mines and plants near Kolwezi in the Democratic Republic of Congo (DRC).[70] For three years Glencore ran a large copper refinery at Luilu in Katanga province. At that time the operation involved burning ore with mineral content using acid to free up copper, with heavily polluted waste pumped straight into the Luilu river.[71] A study published by NGOs Bread for All and Fastenopfer in 2012 showed how Kamoto Copper Company (KCC) discharged untreated effluent from its hydro-metallurgical plant into the River Luilu. The pH of 1.9 and concentrations of copper, cobalt and lead were above international and Congolese environmental thresholds. In April 2012, the company acknowledged the facts and claimed to have resolved the problem.[72] In October 2013 the authors discovered that waste from the Luilu plant was still being discharged into the River Luilu, only further upstream.[73] Samples of the effluent being discharged into the river after laboratory analysis showed that the pH level, had significantly improved since April 2012, although the acid content remained high. Concentrations of copper and cobalt remained extremely high, with copper concentrations up to six times (9.927 mg/l) higher than the thresholds set by the Congolese Mining Code for effluent.[74] Cobalt concentrations were up to fifty-three times (53.59 mg/l) higher than World Health Organisation (WHO) thresholds for drinking water. The authors therefore concluded that Glencore continued to pollute the River Luilu and to exceed regulated environmental standards.

[70] Newsrelease 4/2007 Katanga Mining Limited

[71] The Observer, April 14 2012. "Mining giant Glencore accused in child labour and acid dumping row". J. Sweeney

[72] Report: PR or Progress? Glencore's Corporate Responsibility in the Democratic Republic of the Congo, June 2014. Author: Bread for All, Rights and Accountability in Development (RAID) and Swiss Catholic Lenten Fund. p8.

[73] Ibid.p9

[74] Ibid.

Chapter 6:

Assessment of ESG Principles in SADC: Conclusions snd Recommendations

The projects considered establish a nexus between South African banks and particular mining projects in the SADC region. The projects faced heightened public scrutiny as a result of the adverse ESG impacts that resulted from mining company conduct. On an aggregate basis, and applying a strict results-based analysis to reach conclusions, the picture that emerges of bank implementation of ESG principles in the SADC region reveals that these efforts are not effective in achieving stated objectives. Key factors that support this conclusion are the number of projects transgressing principles, the size of projects, significant monetary amounts, diverse funding methods, and geographic spread of countries implicated in the ESG transgressions. These factors suggest that given the importance of the SADC projects to the business of banks, internal frameworks on ESG would lead to the suspension of client relationships or at a minimum result in banks putting a halt to funding discussions until these issues were rectified. This however is not the case, with results indicating that ESG risk-management principles of SA banks are not achieving their objectives in the region. Given the importance of mining to the region, countries in SADC have continued to review and enhance legislation on how companies should approach ESG issues in licenced mining projects. Laws are readily accessible and it is not difficult for banks to establish the ESG provisions for potential projects in SADC countries. From questionnaire responses it is clear that ESG policies of the banks are detailed, clearly establishing procedures that need to be followed internally before projects can be deemed compliant with bank standards. It is for this reason that the implementation of principles can be characterised as ineffective.

The answer to the lack effectiveness of the ESG principles needs to be sought in the private and public domains. In the private domain, in banks, the lack of capacity – in terms of staff numbers, skills and institutional support – to implement their policies could be leading contributors the status quo. An additional contributing factor could be the corporate culture of banks. Policies have been put in place, but it is impossible to determine the extent to which core management in banks at the operational level takes them seriously and ensures full implementation. A tick-box approach that lacks commitment is more likely to produce the outcomes seen. These considerations are not conclusive, but they do suggest the role of subjective factors as drivers that affect the effectiveness of principles. For more certain answers, empirical evidence such as regulatory filings on ESG policy implementation would help provide a clear picture on causality.

Equally important for causality and effectiveness is the public domain and the role played by SADC governments. Several of the case studies describe ESG violations that have occurred with the implicit or explicit support of SADC governments. The support is not the result of purely malevolent motivations on the part of governments, but appears to be part of efforts to actively increase mining development in order to ensure that projects contribute to the growth of national economic activity. Some of the ESG violations have occurred as a result of apparent political interference by influential individuals seeking specific outcomes in the face of aggrieved citizens and workers. Other instances show a state of affairs where governments have developed the ability to deal with environmental violations but lack the capacity to regulate violations in social and governance categories. The cumulative picture that emerges from this analysis points to the need for a review, reform and implementation agenda that would ensure that existing ESG principles become more effective from the perspective of SADC governments and South African banks.

The future of ESG policy

The issues raised by the results of the assessment of ESG principles in South African banks and mining projects in SADC call for a forward-looking approach. Having considered the effectiveness of the principles, questions need to be asked about the current status quo. Does the existing configuration of ESG policy implementation enjoy legitimacy among its many stakeholders? Are there things that can be done differently to achieve the goals of ESG? If so, what in light of evidence that is not emphatically positive?

The question of legitimacy and ESG frameworks

The engagement with banks during this study shows that they have committed resources in an effort to achieve compliance with ESG principles and allied sustainability reporting that is now a well-established practice. Some of the banks engaged have established committees to deal with ESG issues, while BASA retains a forum to deal with sustainability issues. The question remains whether these efforts in their present guise confer a status of legitimacy among stakeholders beyond the narrow community of peer banks.

A practical staring point to consider legitimacy beyond the limits of a small club of banks is the institutional arrangements that govern the development and application of ESG principles. The EP is the most influential set of principles used, and thus is used in this critique. The EP used in South Africa's banking sector is created by a club of 83 financial institutions that develop criteria to be implemented by members. Beyond interaction with the IFC, there is little evidence of outreach by the EPA to civil society, academia or non-private sector actors with proven expertise who could contribute to the development of the criteria. This is in contrast to the UNPRI or GRI which are joint public-private sector initiatives created through committees that include expertise drawn from a variety of constituencies. The founding parties of the EP are drawn from a homogenous group of large global banks based in the United States and Europe[75] that created a set of principles to regulate conduct that has primary impact on communities in the developing world. The lack of input from organised developing world stakeholders into the standard is a significant weakness, detracting from the objectivity of the principles. There are numerous precedents of negative results when a small group of institutions with vested interests are allowed to determine the standards of conduct for bank lending in communities that lack resources and information on the practices. A most apposite recent example is the global financial crisis of 2007/2008, where the small group of institutions in question were credit ratings agencies (CRAs). In the scenario of ESG principles, banks are in a similar position; extremely influential on conduct in the market, but unaccountable. An added challenge with banks is the reputational interest they have in being seen to address the social and environmental costs of lending activities in the developing world. This is done alongside the desire to make attractive returns on investment from lending activities that implicate reputational interests. These objectives are not decidedly compatible, and this has consequences for legitimacy. The governance arrangements created by EPA banks to police their own conduct without engagement with banking sector standard-setting bodies or independent experts can in the long-term only produce negative results. With CRAs the result of unaccountable governance arrangements was a global financial crisis and recession. In the area of ESG these consequences are continuing, and include numerous instances of ESG violations by mining companies funded by banks and increasing legal challenges from non-banking stakeholders about these violations.

ESG risk regulation for the SA financial sector?

One method of addressing the inadequacy in the effectiveness of ESGs as implemented would be regulation. The South African banking sector is well-regulated and state intervention should not automatically increase regulatory compliance costs for companies. In order for the suggestion to be considered seriously it must first overcome the significant hurdle of qualifying to be categorised as justified action by the state. Securing the cooperation of stakeholders would also be important.

In the South African context, the idea of regulating the financial sector to realise a justifiable social goal by the state is not exceptional in banking regulation. Examples of socially motivated regulation include the Financial Intelligence Centre Act ("FICA") and regulations that are derived from the FATF (Financial Action Task Force) recommendations. FATF is a global anti-money-laundering standard-setting body and in accepting its recommendations banks accept that the country's financial sector should not be used by to achieve criminal objectives. Additional regulation of this type includes the mainstream prudential regulation of the banking sector. South Africa is a member of the BASEL Committee on Banking Supervision, which is the primary standard-setter for the prudential regulation of banks and a forum for banking supervisory issues. The state has a justified social interest in maintaining the "safety and soundness" of the banking

[75] See Equator Principles adoption date at http://www.equator-principles.com/index.php/members-reporting. The founding banks include Citigroup of the United States, Barclays plc of the United Kingdom, Unicredit of Germany, and Rabobank of the Netherlands.

system in ensuring that customers do not lose their savings as a result of financial shocks and systemic failure. These examples of socially justified regulation involve home-grown banking regulation backed by legislation that is normatively a derivative of principles adopted through state participation in global standard-setting bodies. South African legislation that implements the objectives of this state interest and acts to prevent adverse impacts on society includes the Banks Act of 1990, the National Credit Act of 2005 (the NCA) and the Consumer Protection Act of 2008 (the CPA). These laws regulate the conduct of South African banks with the objective of eliminating the risk of potential harm they might inflict on society by their business conduct. The statutes are enforced by government regulatory bodies that include the SA Reserve Bank (SARB), the Financial Services Board (FSB) and the National Credit Regulator (NCR).

Resistance to inquiries into the greater formality of ESG implementation can be expected. ESG principles are likely to be a peripheral concern for the banking sector. The experience with the push by the South African government to achieve access to financial services for segments of the national population previously excluded from making use of such services (for a variety of structural reasons) is instructive in this regard. The issue of “banking the unbanked” was historically neglected by South African banks and began its existence as policy on the margins of banking sector issues. The Financial Services Council (FSC), a statutory multi-stakeholder forum with members drawn from government, community groups and the banking sector, developed financial sector codes which (among other things) determine and monitor methods used to establish adequate access to services provided by banks in the Banking Association of South Africa (BASA). This experience with the codes is a strong example of a policy issue moving from the margins to the centre of concerns in the banking sector. The success of moving improved ESG policy implementation will rely heavily on the commitment of the South African government to reaching this goal.

Recommendations for greater effectiveness of ESG frameworks in SADC mining

This study has evaluated a range of issues in order to determine whether South African banks are funding mining projects in the SADC region in a manner that is consistent with their commitment to ESG principles. A number of recommendations have been identified as a result of insights gained from this enquiry.

1 Standardised ESG principles should be developed by SADC states for application to all banks that fund mining projects in member states.

2 Consideration should be given to the insertion of provisions in law or regulation for the imposition of fines for violations of clearly defined and nationally accepted ESG principles that occur as a result of the practices of banks.

3 Central banks in the SADC region should consider developing an ESG policy and principles statement for banks. Consideration should be given to including compliance with the statement as part of bank inspections.

4 Civil society and SADC governments should engage the Equator Principles Association (EPA) and the IFC (International Finance Corporation) on the review or development of the next set of Equator Principles.

5 Governments should engage with ESG standard-setting bodies to develop a skills programme for bureaucrats. Efforts should be made to increase the pool of third-party consultants with expertise in the area of ESG. Establishment of an accredited programme for third-party work on EPA should be considered in conjunction with environmental and engineering bodies.

6 Civil society and SADC governments should engage the EPA and IFC on ways to develop a mechanism that allows affected groups to access ESG reports prepared on mining projects without groups needing to resort to legal requests.

7 Capacity-building should be increased within SADC for the relevant government departments to handle ESG issues as a regulatory function.

8 An awareness-raising campaign on ESG as an issue should be instituted by SADC governments, banks and mining companies in mining areas, and avenues available for engagement by affected parties should be highlighted.

Conclusion

A major insight delivered by this study is the fact that the ESG frameworks that South African banks apply to mining projects financed in the SADC region are all developed in-house. This means that any explanation concerning the effectiveness of these frameworks in respect to mining projects must be sought within banks themselves. The Equator Principles, which are external to banks, are an ESG risk-management framework that is highly regarded in the South African banking sector, but the standard is not applied to mining transactions frequently and does not provide useful insights into the factors that determine the effectiveness of bank ESG implementation. A number of issues have been considered with respect to the transactional nature of mining funding. These issues (such as asymmetries in information between financier banks and mining communities, the use of third-party experts and the implementation and monitoring of ESG principles by banks within the primacy of the private realm, away from public scrutiny) have implications for the transparency and accountability of these frameworks. Deficits in the latter invariably raise the issues of the legitimacy of these in-house ESG principles among the large community of public stakeholders in SADC that are found outside of the closely-knit community of SA's financial sector. The ongoing development of ESG principles globally points to a field that is in transition, as evidenced by revisions of the EP, discussions, and unilateral actions by some banks to widen the application its principles. There are also emerging groups with multinational membership that are working informally towards the increased uniformity and formalisation of ESG principles. ESG in the SA financial sector should be located within this transitional context. ESG as an area has appeared on the SA financial landscape recently. SA banks on the face of it have taken the area seriously, and have created internal procedures that allow for the inclusion of ESG concerns in decisions on mining projects (and other projects). On a strict results-based analysis, however, this study reveals that the ESG frameworks as applied by these banks are not proving very effective in upholding the values found in their ESG principles when applied to funding of mining projects within SADC. The evidence indicates that SA banks are continually financing mining deals in the region that continue to have negative social, environmental and governance consequences for affected communities. Across a range of factors (including the numbers and geographical spread of mining projects that violate ESG principles, the monetary sums involved, the variety of funding techniques used, and adverse impacts on communities and the environment), bank funding decisions contribute to mine actions that extract high costs from communities. These costs far exceed what could be expected if ESG frameworks were effective and if relevant legislation in SADC countries were deferred to.

The results point to the need for the consideration of intervention to improve ESG policy implementation of the South African financial sector banks. A number of issues should ideally be included in such an agenda, which implicate actors on both sides of the private/public divide in the banking services industry. Areas for intervention would include looking at the role of SADC governments in contributing to ESG violations by prioritising mining projects for greater contributions to their fiscus. The prioritisation of investment and job creation in the sector should not result in support for mining practices that take precedence over regulations developed to have positive effects on communities and on the environment. Other areas to look at include the lack of empowerment of communities on ESG issues; apparent state inability to enforce regulations with respect to mining and financial institutions; the lack of accountability among banks in the implementation and reporting of their ESG compliance levels; and a consideration of ways to strengthen private sector capacity in order to achieve greater effectiveness of the ESG principles to serve mining communities in the SADC region, as opposed to what currently appears to be service in achieving the reputational goals of banks.

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OSISA is a growing African institution committed to deepening democracy, protecting human rights and enhancing good governance in the region. Its vision is to promote and sustain the ideals, values, institutions and practices of open society, with the aim of establishing vibrant and tolerant southern African democracies in which people, free from material and other deprivation, understand their rights and responsibilities and participate actively in all spheres of life.

In pursuance of this vision, OSISA's mission is to initiate and support programmes working towards open society ideals and to advocate for these ideals in southern Africa. Established in 1997, OSISA works in 11 southern African countries: Angola, Botswana, DRC, Lesotho, Malawi, Madagascar, Mozambique, Namibia, Swaziland, Zambia and Zimbabwe. OSISA works differently in each of these countries, according to local conditions.

OSISA is part of a network of autonomous Open Society Foundations, established by George Soros, located in Eastern and Central Europe, the former Soviet Union, Africa, Latin America, the Caribbean, the Middle East, Southeast Asia and the US.

SARW is a formative project within the Natural Resources Governance Initiative of OSISA. Its main objective is to monitor corporate and state conduct in the extraction and beneficiation of natural resources in Southern Africa. It seeks to assess the extent to which the policies, practices and efforts of the players in the sector can and do contribute to sustainable development. Other specific objectives include:

- To consolidate research and advocacy on natural resources extraction issues in Southern Africa;
- To put a spotlight on the specific dynamics of natural resources in Southern Africa, building a distinctive understanding of the regional geo-political dynamics of resource economics;
- To provide for researchers, policy makers and social justice activists especially in academic and civic spaces- a platform of action, coordination and organisation, in the watching and strengthening of corporate and state accountability in natural resources extraction;
- To highlight the relationship between resource extraction activities and human rights as they obtain on the ground, and develop advocacy efforts that engage this reality.