MSCI ESG THOUGHT LEADERS COUNCIL

FROM MSCI ESG RESEARCH INC.

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INTRODUCTION TO THE MSCI ESG THOUGHT LEADER COUNCIL

The goal of the MSCI ESG Research Thought Leaders Council is to maintain our leading edge in research methodology by regularly seeking feedback and opinions from external experts in key industries and relevant ESG issue areas. The MSCI ESG Research Thought Leaders Council consists of a series of about four panels annually, with three to seven members on each panel. We aim to assemble international experts with recognized leadership and expertise on the topic area related to the panel.

The third council was held on July 22nd, 2014 on the Mining industry. Panel members were asked to review MSCI ESG Research's proprietary IVA Rating methodology, as well as specific industry and company reports before participating in the official panel call with MSCI ESG Research analysts.

KEY TAKEAWAYS

- The panel felt that better granularity in our evaluation and understanding of the implementation of sustainable policies at the operational level, as opposed to just the presence of sustainable policies at the corporate-level, would best serve our clients. Contractual obligations, regulatory drivers, verification from external parties, and a comparison of capital committed to pollution prevention and rehabilitation were suggested as strong ways to verify both company practices and performance records. The panel further recommended asking pointed questions to management teams about policy implementation and management systems during our dialogue with companies.
- Labor risks are interconnected with regional issues but often come down to ensuring a fair living wage for a workforce. The panel also expressed that employee engagement was key, and that there is an opportunity in our research to further elaborate on how well management is in touch with the sentiment of their workforces.
- Panelists identified community ownership/ beneficiation, local sourcing, and ongoing support for local economic development as the most important factors in building stable community relations. A lack of focus on community relations can be detrimental to a project, as blockades and violent protests can drive a company out of major investments. MSCI ESG Research can expand on these themes, and should be clearer in reporting benchmarking of shared community value.
- Mining will not get easier, as mines age, ore grades decline, and growth is expected in areas of environmental, social, corruption, and political risks. However, technologies and best practices to address many of these issues exist, and savvy mining companies use environmental and social performance as a differentiator for investors and project approvers.

COUNCIL MEMBERS

James Brice
EBS

Peter Major
Cadiz

Craig Ford
NPB Consulting

Kernaghan Webb
Ryerson University

Sacha Backes
International Finance Corporation

Anne-Maree O'Connor
New Zealand Superannuation Fund

Malcolm Gray
Investec

KEY DISCUSSION POINTS

1. LABOR MANAGEMENT

Council members thought that our assessment of labor management required a broader context. It was suggested that as a lesson learned from the South African strikes our assessment should consider the interconnectedness of many issues linked to labor management, such as poverty of the workforce, lack of a "living wage", political issues, health and safety, poor social infrastructure, macroeconomics of a region, decreasing employment, radicalization among union members, the success of previous violent campaigns for wage increases, and an increase in automation and decrease in low-skilled jobs. The use of contractors is also variable with different impacts on labor relations. Some council members also cautioned that company management was often too detached from the realities of their workforces. By the time company management became aware of labor issues, many disputes were already entrenched as communication from management during times of labor strife is often not reliable. However, to distinguish between the qualities of management, the council suggested evaluating the implementation of labor management systems, quality of dialogue, and the use of arbitration.

2. COMMUNITY RELATIONS

All council members agreed that strong, on-going community relations programs are a critical component of viable metals and mining operation. The council emphasized the importance of verification from reliable sources of both allegations against projects as well as management practices that MSCI ESG Research provides in company assessments. There was some disagreement in how long news of protests or controversies and events of adverse impact on communities should be considered in our assessment. All panelists agreed that the most recent controversies should have the highest weight, and some council members expressed concern that unless a sign of protest can be verified within three years it should no longer be considered in a company's analysis and rating. However, council members also emphasized that legacy issues can play a pivotal role in a company's relationship with local communities.

One member stated that companies either get population resettlements (that precede operations) right, or face long-term community risks, and that community relations experts need to be involved at the start of a project as much as any other business teams. The council felt that with nearly all companies making high level commitments to support local stakeholders, the key differentiator of performance was the effectiveness of policy implementation; and our assessments would be best served by evaluating the commitment of management and how ingrained these commitments are throughout the company. One council member suggested that there were regulatory drivers for strong performance in some regions but not all. All panelists agreed that assurances of performance were important. For instance, many council members thought that the International Finance Corporation (IFC) Performance Standards on Environmental and Social Sustainability were among the strongest because they touch on all the important issues such as stakeholder engagement, and companies financed by the IFC are contractually obligated to meet IFC standards. Further, the council advised on ways for communities to voice concerns, such as through community development councils and grievance mechanism channels. Council members also mentioned that the time it takes companies to respond to grievances would be an important measure. Several council members suggested that companies able to demonstrate shared value are best poised to succeed in resource extraction, as communities that receive benefits (in the form of infrastructure development, economic stimulus, employment, and ownership) from the project or company may be less inclined to strike or blockade access to site. One council member also suggested that developing a local economy is important to reduce risks of illegal artisanal mining on company property. This requires a shift in the mindset of companies preparing their entry strategy in markets where few economic opportunities exist for local community members. Companies that resist this change may have difficulty convincing the affected stakeholders that the project should proceed.

3. **Toxics and Waste**

   There was some disagreement in the panel on the value of benchmarking emission metrics. The panel concluded that focusing on resources to mitigate risks was important, both in terms of resources of regulators for enforcement and on the part of companies. In particular, some members thought that it would be insightful to consider closure or rehabilitation funding as a signal for both a commitment to environmental management and mitigation of unanticipated environmental costs. Some panelists expressed concern that almost all companies are underfunding their closure plans. Further, the panel concluded that the commitment of companies toward preventing environmental mishaps is best measured by the amount of capital committed to pollution prevention. Panelists also noted that technology to prevent environmental accidents is available, and that it is more a question of whether a company is willing to spend enough capital to mitigate risks of accidents. Two areas the panel suggested that MSCI ESG Research should focus on to improve our assessments were water quality and long-term chemical stability such as acid mine drainage risks. Once again there was also consensus on the panel that implementation of policies was key. The existence of proper procedures should be considered in the assessment. Two important aspects of proper procedures that were discussed included monitoring and the delegation of shut-down authority within a company.

4. **Industry Emerging Trends**

   The panel suggested several key trends that already affect and will continue to define ESG performance of mining companies: Industry continues to shift into more difficult terrain – Mine grades are decreasing, forcing the industry into areas of poor infrastructure, high environmental sensitivity, and risky political environment. This may provide knock-on impacts on the economy, but one panelist suggested that investors may be concerned about controversial projects entering their portfolios. Increasing focus on community issues – Protection of indigenous rights is becoming a focus, especially in Latin America and Canada. Mining is increasingly aligned with development opportunities and the importance of building local supply base for materials, services, and labor will improve local support.

Communities will increasingly expect companies to provide infrastructure, education, and economic developments. Labor relations will continue to be a risk – With difficult labor relations and low cost of capital, an increase in mechanization of production is becoming a trend in the industry. As such, mines are less flexible with capital heavy equipment. Labor intensive operations can provide flexibility as long as they address social issues. A drop in the price of metals will put additional pressure on leveraged operations. Water – Water sourcing continues to be a rising cost and conflicts over available resources is a major catalyst for disastrous community relations. The panel emphasized the importance and benefit of closed circuit water systems that will require additional investments in wastewater treatment but also give companies stronger control over water supply

5. **Competitive Advantages**
   The panel conceded that long-term growth opportunities relate to effective management of ESG risk. Demand for metals will remain while the path to produce these materials will become more difficult; therefore, navigating the difficulties related to ESG concerns will place companies in the front-runner position and will prepare them to weather shifts in the industry landscape. That said, one panelist remarked that the lack of ESG experts on boards of companies is a surprise and is one of the major weaknesses in the industry, and thought that companies with board level expertise related to ESG issues will have competitive advantages.

ABOUT MSCI ESG RESEARCH PRODUCTS AND SERVICES

MSCI's ESG products and services are provided by MSCI ESG Research Inc. and are designed to provide in-depth research, ratings and analysis of environmental, social and governance-related business practices to companies worldwide. ESG ratings, data and analysis from MSCI ESG Research are also used in the construction of the MSCI ESG Indexes. MSCI ESG Research is produced by MSCI's indirect wholly-owned subsidiary MSCI ESG Research Inc., a Registered Investment Adviser under the Investment Advisers Act of 1940.

ABOUT MSCI

For more than 40 years, MSCI's research-based indexes and analytics have helped the world's leading investors build and manage better portfolios. Clients rely on our offerings for deeper insights into the drivers of performance and risk in their portfolios, broad asset class coverage and innovative research. Our line of products and services includes indexes, analytical models, data, real estate benchmarks and ESG research. MSCI serves 98 of the top 100 largest money managers, according to the most recent P&I ranking. For more information, visit us at www.msci.com.