

## Transparency International Anti-Corruption Helpdesk Answer

# Corruption risk mitigation in the mining sector

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The mining sector is especially vulnerable to corruption risks due to its technical complexity, relations between the private and the public sector, and large revenues. The implementation of mitigation measures is crucial to address corruption risks in the sector. However, an effective risk mitigation should be preceded by proper identification and assessment of corruption risks. Good practices in corruption risk mitigation when awarding mining contracts include ensuring transparency in contract negotiation and licensing processes, transparency of beneficial ownership, promoting business integrity, having adequate regulatory frameworks, and preventing illicit influence and conflict of interests.

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## Query

What is the conceptual definition of corruption risk mitigation in the mining sector, and what are good practices in the implementation of mitigation measures. Of particular interest is the award of contracts and environmental permits.

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## Defining corruption risk mitigation

In general terms, corruption risk mitigation refers to the implementation of measures to reduce the probability of corruption risk occurring or to reduce its impact (Nest 2017). That implies to monitor those measures to ensure that they fulfil their purpose and to redefine them if necessary (Stenberg Johnsen 2015). What this means in concrete terms depends on how “corruption”, “risk” and “mitigation” are defined in the specific context or sector. For instance, what corruption means in the mining sector would be determined by the opportunities for corruption in this particular sector, as discussed later in section 3.

The general idea of risk implies “the possibility of loss” (WDR 2014). The definition of risk would also depend on how it is perceived. Individual or collective perceptions of risk are relevant since they can lead to action or a lack of action, and those perceptions can have significant costs. For example, perceptions of risk can perpetuate unconstructive behaviours, lower social trust or

## Main points

- Corruption risk mitigation is not about eliminating risks but about reducing those crossing the risk level of tolerance.
- Perceptions of risk can be as important as the risk itself.
- An effective corruption risk mitigation should be preceded by proper risk identification and assessment.

discourage investing in productive activities (Stenberg Johnsen 2015). Hence, risks should be considered in their social and cultural complexity (Stenberg Johnsen 2015).

The idea of mitigation refers to the purpose of the concept. The objective is not to completely eliminate corruption risks, which is an impossible endeavour, but to reduce it. Thus, the idea of mitigation implies determining a tolerable level of risk for a particular activity (Stenberg Johnsen 2015). The level of risk tolerance will be determined by political considerations and assessments of the damage that different types and levels of corruption may cause (Stenberg Johnsen 2015). This level might change over time. This implies a classification of risks between those crossing the established threshold and those that

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do not. It also implies that only those risks beyond that threshold will be addressed. Hence, only mitigation measures required to reduce the risk to an acceptable level will need to be applied (Stenberg Johnsen 2015).

## Planning and implementing corruption risk mitigation

One of the problems in corruption risk mitigation is that mitigation measures are often chosen without relevant information due to weak or missing risk assessment methodologies (Stenberg Johnsen 2015). This involves the peril of applying standard or repetitive measures regardless of the level of risk severity, as well as ineffective measures in the absence of knowing how to prioritise the corruption risk that need to be addressed (Jenkins 2016). Thus, risk mitigation should be part of a bigger risk assessment process with the following steps (Stenberg Johnsen 2015): risk identification, risk assessment, risk mitigation. The identification phase consists of identifying the types of risk in the system, while the assessment phase is about estimating the magnitude of each type of risk.

Effective risk management requires a proactive, systemic and integrated way of working (WDR 2014). According to the WDR (2014), this means achieving a proper balance, coordination and complementarity between the contribution from the state and the contribution from individuals, civil society and the private sector. Hence, it is necessary to shift from unplanned and ad hoc responses when crises occur to proactive, systematic and integrated risk management (WDR 2014).

### Creating a corruption risk mitigation plan

The formulation of a mitigation plan requires two main steps: identify existing corruption mitigation

measures and develop an action plan (UNDP 2016).

It is important to evaluate the existing corruption risk mitigation strategies and assess their effectiveness and institutional gaps. This analysis will help determine whether those initiatives can be redesigned, strengthened or enforced. For example, when the objective is to increase transparency in bidding and contracting, it would be necessary to check the existence and effectiveness of freedom of information laws and other transparency initiatives (UNDP 2016).

A corruption risk mitigation plan should provide information on how priority corruption risks will be addressed, with a detailed schedule indicating recommended mitigation tools and actions, responsible actors, capacity to undertake the proposed action, time, budget, and indicators and measures of progress (UNDP 2016).

Risk management experts recommend basing the decision to engage in mitigation on a cost-benefit or cost-effective analysis. Following Stenberg Johnsen (2015), the basic decision-making principle should be based on the costs of a specific type of corruption and the effectiveness of the tools to target that type of corruption. The two main steps in this analysis are the identification and measurement of the benefits generated by anti-corruption activities and the identification and calculation of the costs. Different measures and valuation methods are required for the different types of corruption (Johnsen 2014). Also, the feasibility of the cost analysis will depend in part on whether the consequences of corruption are more direct or indirect, and if multiple types of corruption are being addressed. After the benefit-cost analysis across a number of areas, the World Development Report (2014) find that risk preparation is often beneficial for averting costs.

### The importance of implementation

Without the implementation of corruption risk mitigation, risk assessment will not fulfil its ultimate

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purpose. The implementation phase provides the opportunity for change and improvement.

Successful implementation requires shared action and responsibility, and effective coordination among various government institutions, state-owned enterprises, independent oversight agencies, the private sector and citizens (WDR 2014). Following United Nations Development Program guidelines (2016), there are four main activities that should be part of the implementation stage. One is the mobilisation of stakeholders to ensure that they are adequately informed and engaged throughout the implementation process. Secondly, there should be active and regular communication to other relevant actors about objectives, progress and the key milestones of the implementation. Thirdly, balance quick-wins and long-term changes, and ensure respect for institutions and processes beyond implementation. Finally, measure and monitor the mitigation actions and the lessons learned (UNDP 2016).

## Corruption risks in the mining sector

The mining sector is characterised by complex structures and technical procedures, relations of dependency for obtaining contracts, licences and permits, and large revenues. In addition, the economic, environmental and social impact of extractive industries requires the existence of extensive regulations (Lindner 2014). All of these characteristics makes the mining sector especially vulnerable to corruption risks.

Corruption risks in the mining sector can take place at every step of the value chain (Lindner 2014): i) award of contracts and licenses; ii) regulation and monitoring of operations; iii) collection of taxes and royalties; iv) revenue distribution and management; v) implementation of sustainable development policies and projects.

The awarding of contracts is particularly vulnerable to corruption. For example, firms might attempt to

bribe the government to get the contract, or some firms might receive more favourable treatment due to their political contacts (Lindner 2014). The content of the licence agreements can also be subject to corruption when, for example, when determining the area of exploitation, the length of the operation, the cost recovery basis, the share of profits, rate of production, environmental concerns, agreed commitments, and reporting and control commitments (Williams et al. 2008).

Two aspects require attention regarding government decisions on the framework for awarding exploration, development and production rights through concessions, leases, licences or contracts (Mayorga 2009): the legal and institutional framework regulating the mining activity, and the bidding procedures. In more concrete terms, the OECD (2016) points to the following corruption risk areas regarding the awarding of mining rights:

- non-transparent and asymmetric negotiation and contracts
- inadequate legislative, regulatory and governance framework of the licensing process
- lack of host governments' technical, human and financial resources to manage contract negotiation
- political interference and public-private collusion
- opacity in the process of reallocation of a licence or contract to a third party
- opacity and discretion in bidding processes
- absence of an open and competitive bidding process
- opaque and complex financial and commercial arrangements
- nature of the market with high entry costs and limited number of competitors

Looking at the facts also helps to identify corruption risks. Sayne et al. (2017) highlight 12 red flags indicating corruption risks in the award of extractive sector licences and contracts:

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1. The government allows a seemingly unqualified company to compete for, or win an award.
  2. A company or individual with a history of controversy or criminal behaviour competes for, or wins, an award.
  3. A competing or winning company has a shareholder or other business relationship with a politically exposed person (PEP), or a company in which a PEP has an interest.
  4. A competing or winning company shows signs of having a PEP as a hidden beneficial owner.
  5. An official intervenes in the award process, resulting in benefit to a particular company.
  6. A company provides payments, gifts or favours to a PEP with influence over the selection process.
  7. An official with influence over the selection process has a conflict of interest.
  8. Competition is deliberately constrained in the award process.
  9. A company uses a third-party intermediary to gain an advantage in the award.
  10. A payment made by the winning company is diverted away from the appropriate government account.
  11. The agreed terms of the award deviate significantly from industry or market norms.
  12. The winning company or its owners sell out for a large profit without having done substantial work.

Corruption risks in contract negotiation may appear in trading in influence, and private interests interfering and capturing decision-making processes (OECD 2016). Also, favouring companies in which public officials have an ownership stake, and embezzlement and misappropriation of public funds could occur in contract negotiations. Moreover, shell companies and the obligation for joint ventures with local companies to operate in a country might also be used to perpetuate elite capture and disguise politicians' manipulations (OECD 2016).

The bidding process also offers opportunities for corruption. For example, they may be rigged by patronage and conflict of interest, resulting in the biased selection of one bidder (OECD 2016). The use of third parties, including intermediaries and joint ventures, may serve that purpose.

Opacity in beneficial ownership creates important risks for corruption in the mining sector and other extractive industries (OECD 2016). The lack of knowledge about the identity of the owners and beneficiaries of entities applying for a mining licence prevents sufficient checks on the applicant's political connections, technical qualifications and compliance track record (TI Australia). Moreover, hidden beneficial ownership and weak integrity controls can be used by government officials to hide their abuse of power, and by companies with a track record of corrupt and illegal behaviour to enter the mining sector and benefit from it.

## Good practices in corruption risk mitigation

Good practices in corruption risk mitigation in the mining sector should be applied by all the actors directly involved in the contract – the government and the companies, at least – plus those indirectly involved, such as the home governments of international extractive firms and donors (OECD 2016).

Mitigation risk in awarding contracts and licences should be largely directed to the improvement of transparency and accountability measures. In particular, effective and clean policy requires transparent, competitive and non-discretionary procedures for the award of exploration, development and production rights; clear legal, regulatory and contractual framework; and well defined institutional responsibilities (Mayorga 2009).

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## Creating a transparent and fairer contract negotiation and licensing process

To prevent non-transparent and asymmetric negotiation and contracts, governments can involve technical and legal experts from other public institutions in the negotiation team (OECD 2016). The OECD recommends that all parties in the negotiation should have access to critical data, together with the full disclosure of contracts and licences in publicly available registers, along with the development of standardised guidelines for licence and contract terms to minimise discretion (OECD 2016).

In the bidding process (OECD 2016), risks associated with opacity and discretion in the process can be mitigated by: making information on all stages of the process publicly available; appointing independent bodies responsible for the technical design of the bid; ensuring effective management of possible conflicts of interest; establishing an online submission process; debriefing bidders on how the decision was made; establishing mechanisms to allow losing bidders to challenge the results; full disclosure of awarded contracts in publicly available registries.

The Mining Awards Corruption Risk Assessment tool (MACRA), developed by Transparency International, is a practical tool designed to build a more transparent and accountable process for awarding mining licences by, first, identifying and assessing the weaknesses in the system through the collection of robust evidence (Nest 2017).

MACRA includes 80 corruption risk indicators that help to map out how the mining awards process works in legislation and in practice, and to assess the corruption risks by analysing the likelihood and impact of each risk. The adoption of a tiered approach scores the risks and helps to identify and select the most relevant corruption risks. The tool also provides an explanation of each corruption

risk and guidance on how to assess the likelihood and impact.

## Ensuring transparency on beneficial ownership

To reduce the opacity of beneficial ownership, governments can take the following three steps (TI Australia): First, implement a robust system for integrity screening including the prohibition of relevant individuals in government from acquiring licences or beneficial interests; criminalise illicit acts to influence officials; require applicants to disclose owner information; verify the beneficial ownership information provided; empower licensing officials to reject applications; publicly disclose information on PEP status and beneficial ownership. Secondly, clearly define key terms, such as beneficial owner and political exposed person. Thirdly, adopt a tiered approach to screening to determine if more checks are necessary considering the risk profile of the licence and the applicant's risk profile.

## Promoting business integrity

Business can play an important role in mitigating corruption risks when securing mining rights and approvals by taking these three key steps (TI Australia): i) know the environment in which they are operating, the regulatory processes involved and assess the risks for corruption; ii) conduct due diligence and know who is the counterpart before engaging third parties, acquiring assets or establishing joint ventures; iii) embed pro-integrity measures by implementing standards for anti-corruption, responsible business and transparency. Transparency International has developed several resources to guide business in this regard, including Business Principles for Countering Bribery (2013), 10 Anti-corruption Principles for SOEs (2018) and Adequate Procedures Guidance to the UK Anti-bribery Act (2012).



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## Have an adequate legislative, regulatory and governance framework

To mitigate the risks associated with inadequate legislative, regulatory and governance framework of the licensing process, the OECD (2016) suggests governments: clearly stipulate in law the rules and procedures of the mechanisms for the award of extraction rights; strengthen existing institutions or create an autonomous body to oversee the allocation and implementation of contracts; ensure appropriate mechanisms for parliamentary oversight; and mandate independent monitoring and auditing of contract implementation.

The criminalisation of foreign bribery by home countries might reduce the number of bribes paid by foreign companies operating in countries with systemic corruption, weak institutions and weak or non-existent anti-bribery laws (Lindner 2014). The Foreign Corrupt Practices Act in the United States and the UK Bribery Act are examples of such legislation (Lindner 2014).

## Prevent illicit influence and conflict of interest

The risks presented by political interference and public-private collusion can be mitigated by enacting strict rules to prevent or limit “revolving doors”. This can be done by introducing a cooling-off period, preventing former officials from taking employment with a company interested in contract negotiations (OECD 2016). Another measure is to subject extractive joint ventures to rigorous anti-corruption safeguards.

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