

DIVISION OF MINERAL RESOURCES
MINED LAND RECLAMATION PROGRAM

MINING PERMIT APPLICATION

DEC #

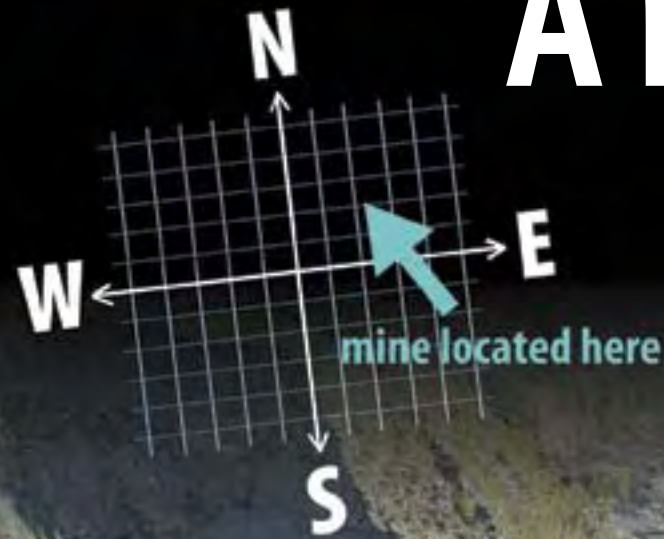
7. MINED LAND PROJECT

1. MINED LAND FILE NUMBER (if assigned)

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A miners' guide

As the search for world-class orebodies pushes exploration into an ever more varied range of countries, the need for political-risk insurance – whether obtained from the public export credit agencies or the private insurance market – has seldom been greater. But before you call your broker, here is a quick guide to the questions he may ask



Right: the Minahasa Raya mine has raised some important environmental issues



to PRI

BY KEITH THOMAS

ONE has to wonder whether it is pure coincidence that some of the most major deposits of minerals lie in politically unstable countries. In such locations, a project feasibility study has to extend to consider the 'what if' factor. Will the regime change? Will that friendly dictator continue in power, or could there be another military coup. Hopefully, the situation is not that bad but nonetheless the investor has to evaluate the political risk.

Confiscation insurance per se has long been part of the suite of perils covered by a typical marine war policy. Ships' hulls and cargoes were traditionally insured against 'war etc risks', and, in the 1970s, a 'blocking and trapping' policy evolved to cover the risks of confiscation, requisition, detention and seizure.

The private market started to compete with the government agencies, and, before long, policies were available to insure not only against government theft of investments but also trade risks against contract frustration.

The early 1980s saw several celebrated confiscation losses involving the extractive industries in Peru, Zambia and Indonesia. It was suddenly evident that governments both could and would interfere with an extractive operation, despite the obvious benefits of foreign investment, know-how, employment and hard-currency earnings that such operations can provide.

Fortunately, in many instances there has been a successful 'work out' and subsequent recovery of the losses, a key feature of this class of insurance.

So, you have identified your target and are about to embark on the project. Political risk and environmental impairment insurances may appear on the agenda, and this paper seeks to help in the understanding of what is key to a private-market insurer's assessment of the risk.

TYPES OF COVERAGE AVAILABLE

The type of policy and the coverages afforded will vary according to the nature of the project and the risks to be insured. Many policies are specially worded to suit the risk.

However, there are 'boiler plate' master wordings upon which the tailored policy will be based. One of the advantages of approaching a specialist broker for assistance in negotiating such an insurance is that the broker will be aware of all the coverage nuances, concessions and structures, including which markets are the most suitable partners.

There are four main types of cover:

■ For financial institutions and banks a policy was developed in the early 1990s known as 'lender's interest'. This policy was devised to ensure continuity of loan repayments following the occurrence of a political event within the host country. The lender could rest assured that, barring a commercial dispute or performance-related incident, the political risk was 'wrapped' and the income stream would be main-

tained intact. Cover would include government theft of the project arising out of confiscation, expropriation, nationalisation or deprivation (CEND for short). Other risks insured include forced abandonment, selective discrimination, licence cancellation, export/import embargo, political violence and war on land. The risk of exchange transfer and currency inconvertibility to cover the transfer of loan repayments and dividend remittances may also be included. Typically, such policies grant 100% cover, the only 'gap' being interest during the claims perfection – or 'waiting period' – usually 180 days.

■ For equity investors, an 'investment insurance' insures against the risk of loss of the investment due to CEND. Such policies could be extended to include currency inconvertibility and licence cancellation. It is sometimes expedient to ensure the coverage includes the risk of 'creeping expropriation', to cover the imposition of increasingly burdensome taxes or export tariffs causing eventual cessation of activities for economic reasons.

■ Confiscation, non-repossession or forced abandonment of mobile equipment. This is something to consider for the exploration phase and even beyond. Sums insured are based on book values. New for old is not a feature!

■ Delayed start-up owing to political violence. This seeks to redress the financial implications of an operation late in coming on stream with the revenue needed to cover the financing cost.

WHO IS THE INSURED?

An obvious question you may think. However, for confiscation insurance the identity of the insured may influence whether a potential insurer will even consider your application.

Some insurers are averse to insuring equity stakes in projects/operations on behalf of the mining company, as, at a later date, shares may be pledged to a lender as collateral.

Thus some insurers are inclined to insure simply the debt on behalf of the lender. This is due to the potentially compromising position for the insurer when exercising rights of recovery following a claim payment. Policies provide, if necessary, for the insurer to take over the insured's rights to the property lost in order to recoup some or all of the claim payment at a later date. The insurer would not wish to be subordinated to another party and thus impair these rights.

If your operation is in the fortunate position of being cash-rich and unlikely to need external financing, then insuring the equity portion is not likely to cause concerns of the sort described above. However, be aware that should circumstances change, the moment that shares in the project's operating company are pledged to a lender, there is always a possibility that the insurer may decline to allow this change of circumstances, and cancel the policy.

An exception to this position might be where the presence of a particular lender is viewed by the insurer as a positive development. For instance, if the European

Bank for Reconstruction and Development were to acquire an interest, an insurer would almost certainly take comfort from this. Arguably, a host government would be unlikely to upset such an influential financial institution.

DESCRIBE THE HOST COUNTRY 'FOREIGN ENTERPRISE'

Do not be surprised if the insurer asks for the precise co-ordinates of the mine. Rest assured he is unlikely to ask to visit.

However, it would not look good in the event of a claim if the underwriter had to confess that he was not aware that the mine was next to an area known for terrorist activities.

Is the location a greenfield or brownfield site? To a certain extent a brownfield site may be a more attractive proposition. A combination of modern mining techniques and higher metals prices can make a previously uneconomic mine today's viable prospect.

Following the closure of the Minahasa Raya mine in North Sulawesi, underwriters became more aware of the way in which environmental issues may prompt host governments to order operations to shut down. Typically, they now implement an environmental exclusion clause.

Today, at least one major insurer also employs a mining specialist on the underwriting team.

(An article is planned for a later issue of *Mining Journal* on the specialist and very separate topic of environmental impairment insurance.)

Other typical questions include:

- What is the foreign enterprise's primary business?
- Date operations first started? (Why are you approaching the market only now...?)
- Breakdown of the ownership and management structure? Does the government hold an interest, and if so how much?
- Are there any major long-term lenders – if so, who?

BREAKDOWN OF FOREIGN ENTERPRISE'S ASSETS

This includes:

- Cash.
- Securities.
- Accounts receivable.
- Land and buildings.
- Plant and machinery.
- Inventory and raw materials.

This level of detail will enable the insurer to understand the nature of the exposures, and even to identify which components may feature as loss recoveries in the event of a claim.

MOBILE ASSETS

We have been approached in the past to insure the non-repossession risk – where the lessor has the risk that the mobile plant and equipment being used by the lessee to evaluate a site cannot be returned.

Considerations include:

- Description of asset to be insured.
- How long will the asset be in the host country?
- Who will have physical control of the asset?
- What is the basis on which the asset has been valued?
- If required, have the necessary re-export licences been obtained?
- Just how mobile is it? Could it be quickly removed to a place of safety?

As a matter of course, insurers insist that all permits and licences are obtained in advance, preferably for the duration of the contract. Should the permits/licences not be valid for the duration of the project, the risk of

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Law changes around the globe

	Law	Status	Comment
Ghana	Minerals and Mining Law of 1986, PNDC Law 153	A new law has repealed Law 153. It was passed by the legislature on December 19, 2005. Presidential assent and publication in the official gazette are pending.	A summary of the draft as of November 2005 was included in the table published in the <i>Mining Journal</i> of November 18, 2005. This is also available from: www.dundee.ac.uk/cepmlp/mining/html/Legal%20Chart%20Oct%202005.pdf
Kosovo	United Nations Interim Administration Mission in Kosovo (UNMIK) Regulation No 2005/2 on the Establishment of the Independent Commission for Mines and Minerals UNMIK Regulation No 2005/3 on Mines and Minerals	Regulations Nos 2005/2 and 2005/3 became effective on January 21, 2005.	Regulation No 2005/2 establishes the regulatory body for application of the Regulation on Mines and Minerals. Regulation No 2005/3 sets forth a regime for granting licences and permits, namely: exploration, retention and mining licences; permits to conduct special operations; and artisanal mining licences. The new regime is expected to encourage both the privatisation of socially-owned mining enterprises and private investment in the sector. www.unmikonline.org/regulations/index.htm
Peru	Supreme Decree No 066-2006-EM	Published on January 5, 2006 (regulations pending).	Establishes a Directorate General of Social Management (Dirección General de Gestión Social) within the Ministry of Energy and Mines. It replaces the prior General Directorate of Environmental and Mining Affairs. Its purpose is "to promote harmonic relationships between mining companies and civil society".
Zambia	Mines and Minerals Act 1995	See comment.	It has been reported in <i>Mining Weekly</i> on-line that the Zambian Government has decided to suspend applications for new mining rights for the next six months with a view to facilitating the transition from a manually-operated mining-rights cadastre system to a computerised one: www.miningweekly.co.za/?show=80831

This table, published quarterly in *Mining Journal*, aims to summarise some changes and developments that either have occurred or are pending in various aspects of the legal framework for mining in some countries. The table does not intend to be exhaustive, and provides only preliminary information. Compiled by the Centre for Energy, Petroleum and Mineral Law & Policy, University of Dundee, International Mining Programme (www.cepmlp.org/mining). Comments and input received from Martin Ayisi are gratefully acknowledged.

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non-renewal is not insured unless this is an act of the host government affecting all similar operations in the country.

Once again, it is probably worth noting that the basis of indemnity is based on the book value, not the replacement cost.

AMOUNTS TO BE INSURED

- What are the debt/equity contributions to the mining venture?
- What guarantees or obligations are given or obtained and from whom? (In very difficult countries, the existence of such security may be an essential factor in determining whether an underwriter would accept the risk at all.)
- What debts are due to the venture?

DESCRIPTION OF OPERATIONS

- What is the percentage of production intended for export?
- What is the percentage of imported material?
- How much does the foreign enterprise depend on technology supplied by the mining company?
- What is the percentage of local people in the management/workforce? A high proportion of indigenous people in the workforce in comparison with foreign nationals is obviously positive. The converse would not be viewed very well.
- Who exercises management control?
- How much tax revenue is generated?

All these questions help the underwriter assess the nature of the risk and how likely it is to become a target for government action. If the mining company is providing essential know-how, generating local employment and wealth, there is less reason for the government to interfere.

SPECIAL ARRANGEMENTS

- Are there any special arrangements between the foreign enterprise and the host government?
- How much does the host government participate in the foreign enterprise?
- What special licensing or authorisations are required by the host government?
- What is the process for renewal of the licences?
- And what's your exit strategy?

The risk of cancellation of the operating licence is obviously a key feature, and there have been a number of 'bad news' stories in this regard, and not just in the mining sector. For this reason, certain countries are 'off-cover' from a political-risk perspective.

GENERAL

- What is the mining venture's social and economic impact on the host country?
- What other operations does the foreign enterprise own in the host country?
- What is the investor's history of operating in the host country, and have there been any incidents?
- Has coverage been declined by any other insurers for the project in question?

SECURITY

- The potential questions here relate partly to the provision by political-risk insurers of political-violence cover, and in certain circumstances it may be appropriate to include terrorism cover. Hence, key questions include:
- Describe the physical location of the project
 - How far is it from the nearest police station/army post?
 - Describe the security at the location (alarms, armed guards, fences, dogs etc)
 - Have there been threats/incidents/losses over the past five years?

CURRENCY RISKS

- What is the projected schedule for foreign-exchange remittances by way of loan repayments and dividend transfers?
- What are the usual foreign-exchange/transfer procedures?
- Is the ore/concentrate/metal exported, and are payments made offshore?
- Are there any delays with foreign-exchange conversation?

Underwriters will generally be aware of the risks of doing business in certain countries. Drilling down to this level of detail enables the underwriter to assess the process of transferring money and where problems may arise. It is a prerequisite of any exchange transfer claim that a deposit of local currency be made in the host country.

TO SUM UP

An application that embraces all the above information should enable the applicant to obtain the most competitive pricing, since the underwriter should have a very good perception of the risk.

All that remains is to agree the terms and pay the premium, but remember that the insurer will expect the insured to act as if uninsured at all times!

And lastly, disclosure. Confidentiality is key, and even a warranty in some policies. Be careful to whom you mention the policy. And check with the broker/insurer first – it may be safer to refer in order to make a general reference to certain risk-mitigation measures.

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