

THE MINING LAW
REVIEW

NINTH EDITION

Editor
Erik Richer La Flèche

THE LAWREVIEWS

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This article was first published in October 2020
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Published in the United Kingdom
by Law Business Research Ltd, London
Meridian House, 34–35 Farringdon Street, London, EC4A 4HL, UK
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ISBN 978-1-83862-481-1

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

BERTRAND-GALINDO BARRUETO BARROILHET & CÍA

DENTONS TASHKENT

EAST AFRICAN LAW CHAMBERS

ESTUDIO MUÑIZ, OLAYA, MELENDEZ, CASTRO, ONO & HERRERA ABOGADOS

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VIEIRA DE ALMEIDA

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BRAZIL

Carlos Vilhena and Adriano Drummond Cançado Trindade¹

I INTRODUCTION

The mining sector plays an important role in the Brazilian economy and accounts for a large proportion of exports. According to the Brazilian Mining Association (IBRAM), national mineral production in 2019 was US\$38 billion, which represented a US\$4 billion increase in relation to the previous year. IBRAM further reports that mineral exports in 2019 reached approximately US\$32.5 billion, which represents 14.5 per cent of Brazilian overall exports. Iron ore was the most exported mineral substance in 2019, representing approximately 68 per cent of overall mineral exports, followed by gold (11 per cent), copper (7 per cent) and niobium (7 per cent). According to the US Geological Survey, in 2019, Brazil was the largest world producer of niobium (88 per cent), and a significant producer of iron ore (19.2 per cent of the world's production), graphite (8.7 per cent), gold (9.5 per cent), bauxite (7.8 per cent), vanadium (9.6 per cent) and manganese (6.3 per cent).

Despite these significant figures, the Brazilian capital market for mining activities does not present the same level of sophistication as in other jurisdictions. Apart from a few companies that are listed on the São Paulo stock exchange (e.g., Vale, CSN, Gerdau, Magnesita and Ferbasa), most capital market transactions involving mining assets are structured in other markets through parent companies, which are usually listed on the Toronto Stock Exchange (TSX) or the Australian Securities Exchange. Junior and mid-tier exploration and mining companies tend to float in those jurisdictions where exploration and mining markets are more developed. The TMX Group reports that more than 30 companies with mining assets in Brazil are listed on the TSX or TSXV, with particular reference to Nexa Resources, part of the Votorantim Group with more than 60 years of existence and several operations in Brazil. In some cases, the original shareholders are from Brazil and resort to a non-Brazilian, more traditional, market to raise capital.

However, these trends may be revised in the near future. In a recent offering in the São Paulo stock exchange in July 2020, gold-producer Aura Minerals (already listed in the TSX) successfully raised approximately US\$150 million and paved the way for other mid-tier companies to resort to the Brazilian capital market as a source of finance for mining operations. It is yet to be seen whether the same strategy could also be used by exploration companies.

Be that as it may, some factors may explain the slow development of Brazilian capital markets for mining, compared with other jurisdictions. The first is the lack of an investment

¹ Carlos Vilhena is a partner and Adriano Drummond Cançado Trindade is a counsel at Pinheiro Neto Advogados.

culture in the mining business, which may be improved given Aura Minerals' landmark offer in July 2020. The second reason is attributable to the historical political crisis that unequivocally impacted the country's economy. President Rousseff was impeached in 2016 and replaced by President Temer, whose term of office ended in December 2018. President Bolsonaro took office on 1 January 2019, for a four-year term, and during the first year in power adopted a pro-business approach, implementing some measures to favour businesses in general and reduce red tape. The outlook for capital markets also looks positive considering the current low interest rates in Brazil, which reached their lowest value in history in August 2020 at 2 per cent per year. The lowest interest rate might result in a move towards investment in capital markets, but the impact of the covid-19 pandemic – which at the time of writing is still significant in Brazil – still needs to be properly assessed.

II CAPITAL RAISING

i General overview of the legal framework

Capital raising in Brazil in general is subject to federal corporate laws, capital markets laws and regulations issued by the Securities and Exchange Commission of Brazil.

Listing in Brazil

There are no specific requirements for raising capital for mining activities in Brazil. Mining companies listed on the São Paulo stock exchange will be subject to the usual requirements in terms of governance and disclosure that are applicable to other industries.

There are no incentives tailored for the mining sector either. Mechanisms such as flow-through shares that may be common in other jurisdictions still have no equivalent in Brazil, although the government has repeatedly stated that measures to foster financing available to the mining sector are being considered. In terms of incentives for exploration companies, at a certain point there were studies to create benefits so that the shareholders of listed exploration companies could deduct exploration-qualified expenditure for tax purposes, but it is still not clear (as at the time of writing) whether the new government will pursue those initiatives or whether other new initiatives will be designed.

As a consequence, the absence of specific rules considering the particularities of the sector, coupled with high costs in terms of governance and disclosure requirements, discourage exploration companies, juniors and companies with smaller projects or operations from listing in the Brazilian market. Yet, the Aura Minerals listing precedent may play an important role for companies to re-assess the potential of the Brazilian capital market for mining.

Foreign investment

Foreign direct investment plays an important part in the Brazilian economy and the legislation imposes few requirements (such as the online registration of the investment within 30 days of the date the funds are converted into Brazilian currency). According to the World Bank, Brazil was the fourth most popular destination for foreign direct investment in 2019, in the amount of US\$78.5 billion. In terms of the overall investment in Latin America, Brazil was the main destination for approximately 44 per cent of investment in general.

Foreign investors are not subject to any legal restrictions on acquiring stakes in Brazilian mining companies in general, although the government interprets the restrictions on non-Brazilian ownership as applying to border areas (i.e., areas within a 150km-wide strip

of land parallel to national borders), as in other countries of the region. Hence, for those companies based in or that have mining assets in a border area, non-Brazilian equity interest is limited to 49 per cent, directly or indirectly.

The Brazilian government also establishes that Brazilian companies that are directly or indirectly controlled by non-Brazilians are subject to certain requirements to acquire rural land, such as the prior approval of the National Institute for Colonisation and Agrarian Reform. Because access to land is of paramount importance to the mining sector, non-Brazilian investors should bear in mind this element in channelling their investment.

Debt

One of the main sources of funding for mining projects is through debt transactions. The National Bank for Economic and Social Development (BNDES) has had a key role in financing major mining projects at more favourable rates. It operates in strengthening the capital structure of private companies and provides more favourable conditions for financing intended for projects that contribute to social, cultural and technological development. The BNDES teamed up with the Funding Authority for Studies and Projects (FINEP) to financially support investment in projects that deal with scientific or technological development, through an initiative known as Inova Mineral. Moreover, BNDES has also been considering the creation of a fund for long-term financing of mining projects and operations, which could participate in up to 25 per cent of financing of a project. At the time of writing, it had not been determined whether BNDES would proceed with such intention and which conditions would apply.

Brazilian commercial banks also provide finance for projects, but in many cases the internal requirements make it harder for projects at the exploration stage to be funded, particularly considering the economic downturn. Banks not based in Brazil may also provide funding for mining projects and usually do so through pre-export finance mechanisms that ensure more favourable taxation.

One key aspect in financing of mining projects and operations is the security package required by banks and other financing institutions. Although it is legally possible to create a security interest over mining concessions in Brazil, in practical terms there may be hurdles in the foreclosure process, which may be seen by banks and institutions as an extra degree of risk. The Brazilian government is currently considering changes in regulations to streamline the mechanism of creating and enforcing security interest over mineral rights and, to that end, the National Mining Agency (ANM) undertook a public consultation in June and July 2020. The results of the public consultation and new proposed regulations are yet to be disclosed to the public.

ii Market overview

Investors in the mining sector are both Brazilian nationals and non-Brazilians. The number of Brazilian investors is not as high as in other sectors of the economy, but their importance should not be downplayed. Vale accounts for a relevant part of the investment in mining, and so do other mining companies, such as Nexa. In addition, private equity funds are frequently seen in the market, as are pension funds and companies in general (for instance, in the past few years, steel companies have also gone into the mining business). Unlike other markets, however, retail investors are not common in the Brazilian market.

Non-Brazilian investors are usually global funds, private equity funds, pension funds or mining companies that seek to reinvest and expand their portfolios, or companies that seek to secure the supply of raw materials for their industries.

iii Structural considerations

Given the economic downturn (which has also been influenced by the covid-19 pandemic) and the market conditions within the mining sector, alternative methods of access to funding have been developed and have become more popular.

Royalty transactions are common and there are now more companies specialising in acquiring royalties. The main hurdle is the fact that Brazilian mining legislation does not provide for the registration of the royalty against title, so the royalty remains a contractual obligation that cannot be imposed on a third-party acquirer of the mining property unless the party expressly acknowledges that it is bound by the royalty. Consequently, a series of legal mechanisms and securities need to be put in place to reduce the exposure and provide more assurances to the royalty creditor. In its plans to ease financing for exploration and mining projects, ANM undertook a public consultation on the matter in June and July 2020 and may remedy this situation in the near future with further streamlined regulations.

During the past few years, there have also been a number of streaming transactions in Brazil. Streaming arrangements are contracts for the regular supply of mineral production under which, upon advance payment of a premium, the buyer agrees to purchase at a fixed discounted and predetermined price, all or part of the mineral production to be extracted by a mining company during a certain period or even throughout the life of the mine. The mining company receives payment up front, which enables it to develop, construct and operate or expand the mine. This arrangement allows the mining company to capitalise on the basis of proven but still unexplored mineral reserves at a cost usually below that of a loan.

These streaming arrangements have been praised by mining companies as they have access to additional fundraising mechanisms to develop the mineral project, and have a purchaser for all or part of future production (depending on the agreement). Moreover, contrary to capital investment financing, streaming arrangements avoid debt-financing costs, particularly at times when credit access conditions are unfavourable.

One major difficulty for Brazilian mining companies in raising capital is the gap between reporting requirements under Brazilian mining law and other typical reporting standards adopted by the market. Reporting requirements in Brazil still abide by legislation enacted in the late 1960s, which employs standards and terminology that is not the same as in the current market (e.g., the inadequate use of ‘measured, indicated and inferred reserves’). This means that the obligations for reporting to the ANM are much less detailed than those required by banks and investors. In some cases, Brazilian companies reach the transitional stage between exploration and mining pursuant to domestic legislation, but still need to undertake further exploration so as to produce the report that provides a resource or reserve that is in compliance with Canada’s National Instrument 43-101 – Standards of Disclosure for Mineral Projects or standards set by the JORC Code.² To bridge that gap, mining associations (i.e., the Brazilian Association of Exploration Companies, the Brazilian Agency for the Development of the Mining Industry and IBRAM) joined the Committee for Mineral Reserves International Reporting Standards (CRIRSCO). As a result, a non-binding,

2 The Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves.

voluntary Brazilian Code for Resources and Reserves that follows the international standards was put together and submitted to CRIRSCO, which will also contribute to the formation of qualified persons in Brazil.

ANM is also considering the acceptance of international reporting standards for the purposes of meeting Brazilian reporting requirements. In fact, this possibility is already provided for in the 2018 Regulations to the Brazilian Mining Code, but still depends on further regulation to be enacted by ANM. Once the matter is properly addressed by ANM regulations, this would be a major change to be certainly welcome by international mining companies and investors.

In the environmental field, the accidents involving the Samarco tailings dam in November 2015 and the Brumadinho tailings dam in January 2019 resulted in more stringent regulation on environmental issues, and more specifically on the use of dams by mining operations, as well as more severe supervision of environmental authorities and public prosecutors. For instance, new regulations on tailings dams have already been issued by the ANM, which contain more requirements for those companies that operate such dams. Dams that use the upstream raising methods are banned and need to be decommissioned over a few years. Mining companies also need to remove most of the premises located downstream tailings dams. In addition, there are a number of bills under consideration at the National Congress and state legislature that adopt more stringent rules and impose obligations such as environmental bonds and insurance for environmental damages.

A final comment should be made with regard to the social and environmental liability of financial institutions that provide funds for mining and infrastructure projects in general. Although no legal provisions impose such a liability, the general practice is that such institutions are deemed increasingly responsible for the use of funds borrowed by companies – particularly those that use environmental resources and could potentially create a social and environmental footprint. The implementation of a National Monetary Council regulation involving the liability of financial institutions started in 2015. This regulation requires each financial institution to put in place a social and environmental policy. This may result in increasing the possibility of financial institutions facing liability claims in the future.

iv Tax considerations

Brazilian legislation does not provide for any tax advantages or incentives to persons engaged in mining activities, or their investors and lenders.

As a general comment, Brazilian corporate income tax (IRPJ) is levied at the rate of 15 per cent on taxable profits. A 10 per cent surcharge is levied on the actual profits, presumed profits or profits determined by the tax authorities, in excess of 240,000 reais per year. Taxable profits are ascertained by deducting the operating costs and expenses from the gross income originating from the company's core activity and incidental businesses. Some of these costs and expenses are not deductible because of their nature or the amount involved. There are also provisions for tax exemption once a company's taxable profit has been ascertained.

Moreover, Brazilian legal entities are allowed to carry forward losses indefinitely, which is of paramount importance for companies that undertake exploration, development and later mining activities; however, such losses can only offset 30 per cent of taxable profits, which can result in deferral of the utilisation of the losses in the event that the legal entity sustains material losses and profits that are not substantial.

In some cases, a legal entity may opt for taxation on presumed profits instead of actual profits. Under the presumed profit regime, the base for IRPJ's calculation is determined by

the application of predetermined rates (which may vary depending on the activity carried out), as set out in the applicable law, over revenues derived by the legal entity from the execution of its operational activities. Expenses are not deductible to the Brazilian company when it is taxed under the presumed profit regime and to be taxed under this system, the company's gross income cannot be more than 78 million reais.

As a general rule, the income, capital gains and other earnings paid, credited, delivered, employed or remitted by a Brazilian source to a foreign-based individual or legal entity are subject to withholding tax at a general rate of 15 per cent. As from 1 January 2017, the tax rates on capital gains of Brazilian individuals or non-residents (both individuals and companies) are: (1) 15 per cent for the part of the gain that does not exceed 5 million reais; (2) 17.5 per cent for the part of the gain that exceeds 5 million reais but does not exceed 10 million reais; (3) 20 per cent for the part of the gain that exceeds 10 million reais but does not exceed 30 million reais; and (4) 22.5 per cent for the part of the gain that exceeds 30 million reais. These rates may reach 25 per cent for income paid to a person residing in a jurisdiction deemed to be a tax haven or privileged tax regime for Brazilian tax purposes (i.e., a country or territory where income is not taxed or subject to taxation at a maximum rate lower than 20 per cent, or does not disclose information about the ownership or beneficial owner of the company's income). As regards countries and regimes aligned with international standards of fiscal transparency, in accordance with rules established by the Brazilian tax authorities (on a par with standards set by the Organisation for Economic Co-operation and Development), the minimum threshold of 20 per cent is decreased to 17 per cent.

The social contribution on net profits (CSL) applies to Brazilian companies (including financial institutions) and is calculated on the net profits before the allowance for income tax, adjusted by the additions, exclusions and offsets prescribed by tax law. The CSL rate is 9 per cent and the figures paid are not deductible from the income tax base (actual profits).

Federal taxes – PIS (Programme of Social Integration) and COFINS (Contribution for the Financing of Social Security) – are levied at the combined rate of 9.25 per cent, assessed over the gross billings of the company.

The tax on financial transactions (IOF) is a tax on foreign exchange, securities, credit, gold and insurance transactions. The Minister of Finance sets the rates of the IOF tax, subject to limits set out by law. The IOF/Exchange is currently imposed on a variety of foreign-exchange transactions. Currently, for most exchange transactions, the rate of IOF/Exchange is 0.38 per cent.

The tax on distribution of goods and services (ICMS) is a valued added tax levied by the state on the circulation of goods (thus covering the entire chain of trades from the manufacturer to the end consumer) and on the provision of intrastate and interstate transportation and communications services. Normally, the transaction value serves as the ICMS tax base. The ICMS is paid by the trader or provider of carrier or communications services.

The ICMS is a non-cumulative tax and, as such, generates a tax credit to be offset by the product or service recipient against the tax payable on future transactions. Each Brazilian state is free to establish its own ICMS rates (generally between 17 and 18 per cent). ICMS tax exemptions, breaks and incentives are granted or cancelled via agreements entered into between Brazilian states; however, states often grant ICMS tax breaks and incentives to attract investment without the approval of other states, generating a 'tax war'.

The tax on services (ISS) is assessed on the services provided by a company or independent contractor or professional, in accordance with a list of services attached to a federal supplementary law. ISS is levied by the local municipality at a rate of between 2 per cent and 5 per cent on the service value.

The National Congress is currently reviewing a significant tax reform with the main purpose of rationalising the tax system and easing tax management both from the perspective of companies and the government. The contents of the reform are still being negotiated based on different proposals. This process will certainly be time-consuming and the reform is not expected to be concluded before the end of 2020.

Mining activities are subject to a statutory royalty (CFEM)³ calculated based on the revenue arising from the sale of the mineral product. The rate varies depending on the substance and, in most cases, the applicable rate is 2 per cent. The highest rate currently is applicable to iron ore, at 3.5 per cent (although it may be reduced to 2 per cent for marginal projects). The rate for gold is 1.5 per cent.

Allowable deductions are restricted only to those taxes that are levied on the sale of products. External transportation and insurance costs are no longer deductible, which increases significantly the CFEM payable by those producers that have logistics associated with their mining business. For those companies that use a mineral substance in their industrial process to create an industrialised product, the statutory royalty will be calculated based on current market prices or a reference price, both to be defined by the ANM.

In addition, three states (Minas Gerais, Pará and Amapá) have created inspection fees. A close review of these state fees shows that they are actually proportionate to the mine production and are tantamount to an additional royalty.

As a measure to foster regional development, exports and the development of infrastructure, there are a number of tax breaks and incentives that investors should consider. Legislation provides for a reduction of IRPJ for industries that are established in the Amazon region or in the north-east of the country as a measure to industrialise those regions.

Exports generally enjoy tax breaks in terms of ICMS and export taxes. Likewise, there are incentives for the import of machinery for which there is no equivalent in the domestic market that will be used in the production of goods for export.

Finally, the government has granted tax benefits to infrastructure debentures so as to reduce taxation on the income paid from debentures issued by special purpose companies created to invest in infrastructure projects (logistics, transportation, energy, telecommunications, sanitation or irrigation). Because many mining projects require associated logistics, these tax benefits should be taken into account by investors. In addition, the government is also considering whether to include mining as a sector that can be financed through infrastructure debentures, which would represent another source of funding with favourable tax treatment, especially for retail investors.

III DEVELOPMENTS

The administration of President Bolsonaro is the most relevant development for business in general in Brazil. Having completed one and a half years in power, President Bolsonaro presents a more liberal agenda for business to ease governmental procedures, reduce red tape and increase economic activity. Mr Bolsonaro's administration managed to approve in

3 Financial Compensation for the Exploitation of Mineral Resources.

Congress a long-expected pensions reform, which was key to the Brazilian economy. The tax reform referred to above is also an important matter to be considered, but its review by the Congress is still at the initial stages.

In terms of mining policy, President Bolsonaro committed to propose amendments to legislation to allow exploration and mining in areas that currently cannot host such activities, such as border areas and indigenous lands. In fact, a bill to regulate exploration and mining activities in indigenous lands was submitted to Congress in February 2020. It is still at the initial stages of review, the timing of which was affected given the covid-19 pandemic and the series of urgent measures to be approved in Congress to cope with the impacts of the pandemic.

In addition to the new administration, the relevant development specific to the mining sector in the past year was the consolidation of ANM as the new regulatory body, by replacing the former National Department of Mineral Production (DNPM) that existed for over 70 years. The agency follows the practice adopted for other regulatory bodies, where decisions are made jointly, sessions are public, proposed regulatory changes go through public consultations at which the agency must review and provide its opinions and suggestions, and procedures become more transparent. This practice has been implemented with a number of public consultations to discuss proposed regulatory changes, and board meetings taking place monthly with public sessions that can be viewed via the internet. We understand that this model will bring significant gains for the industry, but the implementation of all those changes in relation to the former DNPM is made inevitably at a slow pace, which may be seen by the industry as inefficiency. We believe that once the model is entirely assimilated by all public officials and companies, it will represent a progress for the mining sector.

However, as we warned in this article's previous edition, we still have the view that the key is that the ANM is not just a change of name, but an agency that will be endowed with budgetary funds to implement the new administrative framework and meet the purposes expected from a regulatory body. Capacity building and adequate funding still need to be addressed by the Brazilian federal executive to fully allow ANM to fulfil its role.