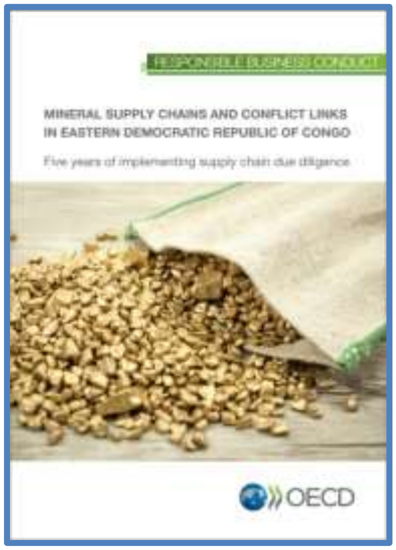
OECD'S FIVE-YEAR UPDATE:
WHAT DOES IT MEAN FOR DOWNSTREAM COMPANIES?



A White Paper by

Douglas Hileman Consulting, LLC

Douglas Hileman, CRMA, CPEA, P.E. President

JANUARY 2016

Douglas Hileman Consulting, LLC

One of a Series of Resources for

Companies Affected by Dodd-Frank Conflict Minerals

See www.DFCMAudit.com

Contents

1.0 INTRODUCTION 3
2.0 GENERAL OBSERVATIONS 4
3.0 SUGGESTIONS FOR DOWNSTREAM COMPANIES 6
4.0 HIGHLIGHTS OF THE OECD 5-YEAR REPORT 8
ABOUT THE AUTHOR 11

OECD's 5-Year Update: What Does it Mean for Downstream Companies?

1.0 INTRODUCTION

On November 19, 2015, the Organization of Economic Co-operation and Development (OECD) published The Mineral Supply Chains and Conflict Links in Eastern Democratic Republic of Congo report[1], a summary of five years of efforts related to conflict minerals in the Democratic Republic of Congo (DRC). This document ("the OECD 5-Year Report" or "the Report") takes stock of five years of implementation of programs and initiatives such as the OECD Due Diligence Guidance on Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas[2] ("OECD Guidelines). The Report was prepared by the International Peace Information Service (IPIS) for the OECD.

Douglas Hileman Consulting (DHC) provides this white paper as a service to downstream companies, and their stakeholders (investors, customers, business partners, organizational affiliates, employees, and others). From the very beginning of Dodd-Frank Conflict Minerals, DHC has provided the business community affected by this legislation with meaningful information to help comply with requirements, manage risks, and improve their efficiency and effectiveness. See www.DFCMAudit.com for a library of white papers and videos, and Mr. Hileman's website for experience in compliance, operations, and non-financial reporting.

This white paper includes sections on:

- General Observations
- Thoughts for Downstream Companies
- Highlights of the Report

DHC suggests that companies use information in the Report in considering risk criteria, sourcing of 3TG, (tin, tantalum, tungsten, gold) and options to increase efforts to achieve conflict-free verification for gold in their supply chains.

[1] See http://www.oecd.org/investment/mne/mineral-supply-chain-eastern-drc.htm

[2] See http://mneguidelines.oecd.org/mining.htm

2.0 GENERAL OBSERVATIONS

DHC offers five observations as key take-aways from the Report.

1. **IPIS has incredible dedication.** The IPIS visited over 1,000 mining sites in eastern DRC in this 2013 – 2014 assessment cycle. This included mines both large (15,000 workers) and small. IPIS noted large swaths of territories they were not able to access. IPIS has collected data on 1,574 artisanal mining sites in the eastern DRC – only about half of those estimated by the DRC mining agency to be in the area. The Report included a map of geographic areas inaccessible to IPIS. Nonetheless, IPIS efforts included "shoes on the ground" in remote, potentially dangerous areas. They visually observed "interference" (as defined) in the region. These efforts are also necessary for a better understanding of a complex issue. Future work in support of the well-being of people in distant parts of the world will benefit from their efforts. DHC recognizes the courage and commitment of the individuals making these important observations.

2. **More and more, it's about gold.** The Report highlights a shift from 3T mining and production to gold – just in the last three years. The instances of observed interference overwhelmingly involve gold – approximately 90% of all the instances observed. Data in the report suggests that more gold is illegally smuggled out of DRC than is officially reported – and that much of this smuggled gold comes from the provinces known to have significant presence of non-governmental security forces, and interference in mining. The OECD 5-Year Report also presents the official production figures from 2006 to 2013. The officially-reported production of gold more than doubled between 2012 and 2013. The 2013 number is a 20-fold increase over 2011, and a 40-fold increase over 2010. DHC suggests that this data highlights increased risk of gold that has been mined – and funded conflict in the DRC – can be making its way into the supply chain of more products. This is arguably the biggest take-away, and the strongest driver for action by downstream companies (see next section).

3. **Some improvements were noted for 3T, but these may now be at risk.** The Report noted improvements in transparency of 3T (tin, tantalum, tungsten) in the last three years, even as commodity prices dropped substantially. By comparison, gold is even more attractive than it was three years ago – both to miners, and to those who would profit by illegal activities, including violations of human rights and theft. Fewer workers, lower prices, and higher overhead to support practices confirming conflict-free practices combine to put pressure on the gains for 3T of the last five years.

4. **The situation remains fluid.** IPIS was able to visit some areas they did not attempt to visit in 2009 – 2010. They were not able to re-visit some areas they visited in 2009 – 2010. Some changes were encouraging:
   - The Report identifies three initiatives sponsored by global companies (Hewlett Packard, AVX, KEMET, Philips, Nokia, and Intel) that appear to have helped improve the transparency and conflict-free sourcing of 3T in the DRC in the past five years.
   - One province changed trade routes to avoid areas known for interference, enhancing traceability of conflict-free minerals.
   - One mine grew to become the largest in the province after implementing OECD conflict free practices. Over the same period, the largest mine – known for recurring interference – slipped to second largest in the province.

   Other changes were less encouraging, such as the dramatic increase of gold production - and likely gold smuggling and interference associated with these activities.

5. **Information is detailed and interactive:** IPIS has compiled detailed information on their observation, and presented it in the form of interactive maps[3]. There is information at the province level, and even the mines. There are interactive maps covering the span of 2007 to 2014. There are even reports analyzing the interactive maps, to help stakeholders make sense of hundreds of data points from field surveys. The 2014 Analysis report was jointly funded by the World Bank and the Federal Public Service Foreign Affairs office of Belgium.

[3] See http://ipisresearch.be/home/conflict-mapping/maps/conflict-mapping-drc/

3.0 SUGGESTIONS FOR DOWNSTREAM COMPANIES

Downstream companies are removed from smelters and mines, and typically mention this in SEC filings. Companies rely upon industry organizations and traceability schemes for critical aspects of their conflict minerals programs. Since the OECD Report focuses on mines in the region, then it doesn't affect downstream companies – right? But being so dismissive could be a risky approach. To help conflict minerals teams navigate these issues, DHC suggests that downstream companies consider five questions regarding the OECD 5-Year Report.

1. **Should companies devote more attention to gold?** In its pure form, the value of gold – ounce for ounce - far outstrips that of tin, tantalum, or tungsten. Intuitively, it would make sense that, of the four 3TG minerals, that gold would be most sought after for illicit gains. Section 1502 of Dodd-Frank refers to "3TG" with no distinction among the four minerals as to how they are regulated, or what companies should do. The OECD 5-Year Report details the meteoric increase in gold production in just the years between 2010 and 2013. Although the OECD Report does not say so, this author notes that there is nothing to suggest that the illegal production or export of gold has not followed a similar pattern of explosive growth during the same time frame. These happen to be the years that the U.S. Congress passed Dodd-Frank (2010) and the first calendar year that the SEC Conflict Minerals was in effect (2013). The Conflict Free Sourcing Initiative tracks how many known smelters or refiners have been validated to protocols that assess the SORs' practices for avoiding the funding of conflict. The percentage of gold refiners lags the percentages of tin, tantalum, and tungsten. Downstream companies may wish to provide extra support and motivation for the sourcing of gold from sources that have been validated as conflict free. **Companies may wish to include a commitment to more emphasis on a conflict-free gold supply chain in the forward-looking statements of the Conflict Minerals Reports submitted to the SEC for the 2015 reporting period.**

2. **Do we understand processes and snapshots? :** SEC filings include requirement to describe management systems, which are a process. If there is (or could be) 3TG from Covered Countries in their supply chain, the SEC Rule requires "due diligence" – another process. The SEC Rule specifies a calendar year reporting period. Companies must make conclusions regarding 3TG in their supply chain as it pertains to that reporting period, although they are not compelled to use specific terms in the SEC Rule. A company's Conflict Minerals Report - and conclusion(s) in it – are snapshots. OECD's 5-Year Report is a reminder of how much things can change on the ground in the DRC, and how quickly they can change. It is a reminder of the importance of maintaining focus on the processes of supply chain engagement. It also highlights the challenges of achieving "DRC Conflict Free" status.

3. **Is it time to adjust risk management practices?** As companies developed conflict minerals compliance programs for "Year One" (the 2013 reporting period), they had little choice but to use the information they received. In Year Two, companies specified more "red flags" that suggested incomplete or incorrect information, and worked with suppliers to improve data quality. As a matter of practice, the term "red flags" was used very broadly, and included everything from transposed digits in a Smelter ID number to duplicate entries for the same smelter to suggestions that some actors in the supply chain were financing unrest in Covered Countries[4]. The broad inclusiveness of many items as "red flags" had the effect of all of these issues being treated the same. But they're not. It may be time for your conflict minerals team to reconsider what gaps, inconsistencies, or signals – and whether the company should take additional actions. The team may also reconsider what should be reported to senior management

4. **Can (should) we preferentially source some 3T from Covered Countries?** The drop in prices for tin, tantalum and tungsten has led to a corresponding drop in mining activity in Covered Countries. This could erode the fragile gains attained by diligent efforts of DRC government, non-governmental organizations, standard-setters, and customers in the industry. It costs money to implement processes and systems, maintain documentation, undergo audits and monitor local trade routes and traders. This is money not spent by groups that exploit natural and resources for destabilizing purposes. There is now an increased risk of back-tracking on progress in 3T in Covered Countries; can (should) a company indicate a preference to include conflict-free sourcing of 3T for some of their supply chain?

5. **How does this change the overall conflict minerals program?** Monitoring is one of the eight components of an Enterprise Risk Management program. OECD's 5-Year Report is the latest in a series of developments that could affect stakeholder expectations, and could require an adjustment to programs for sourcing, manufacturing, contracting, IT/ data management, customer communications, or investor relations. There have been others: court decisions; evolution of industry practice; NGO analysis and reports; and customer requests and expectations. DHC suggests monitoring each notable development as it happens. In fact, since DHC began work on this white paper, the International Conference on the Great Lakes Region issued an open letter on mineral market crisis, asking companies for support to 3T from the Region – precisely the issue in the suggestion above. Monitor the broader landscape periodically – perhaps with the assistance of an independent resource - and adjust programs accordingly.

[4] The SEC Rule defines Covered Countries as the DRC and adjoining countries.

4.0 HIGHLIGHTS OF THE OECD 5-YEAR REPORT

The OECD 5-Year Report makes for good reading – and there is nothing like reading primary documents. The author provides excerpts[5] for those without the time to read the entire report.

- Militarization and "armed presence" are not synonymous with interference, a term used in its own right, and covering both direct and indirect support to those de-stabilizing the region. (p. 7)

- IPIS visited 1,088 sites in 2013/14. IPIS visited 550 mining sites in 2009/2010. IPIS cautions that there are differences in the visits (region, etc.), and direct comparisons between the two reports should not be made. Nonetheless, 100 sites were visited in both campaigns, allowing IPIS to make some comparisons. (p. 7)

- There has been a tangible shift from 3T to gold production between 2009 and 2013/14. (p.7)

- The proportion of 3T sites visited that were subject to interference from non-state armed groups and public security forces dropped by half from 2009 to 2013/14 (57% to 26%). (p. 7)

- The 3T producer Nyabibwe became the largest 3T producer in summer 2013, overtaking the Bisie cassiterite mine, which was considered the most productive 3T mine in the region before that time – and which remains subject to interference. (p. 7)

- Non-state armed groups or public security force presence was noted at 524 of 850 gold mines (61%), compared to 59 of over 200 3T sites (27%). Put another way, over 90% of the mines where IPIS noted militarization and interference were gold mines. (p. 8)

- An encouraging network of initiatives and reforms have appeared and strengthened since 2009/10. These include closed pipeline initiatives, pressure from provincial authorities and industry programs. Large international buyers have returned to the region. (p. 9)

- At the end of 2010, the consolidated number of mining rights and active quarries in the eastern provinces totaled 3,279, with over half in Katanga province. (p. 10)

[5] These excerpts are either direct quotes, or have been modified slightly for brevity. Quotations marks are not used. The page numbers in parentheses direct the reader to the page of the excerpt in the OECD 5-Year Report for readers who wish for more context or detail.

- Gold mining is by far the most important subsector in Eastern DRC's artisanal mining business, with over three times the number of mines extracting gold than 3Ts. This is confirmed by the number of workers engaged and the level of trading at trading sectors. IPIS noted gold available at 136 of 148 trading markets visited. (p. 14)

- 18 3T sites had over 1,000 workers in 2009/10; by 2013/14, that number fell to two. The largest mines IPIS visited in 2013/14 were both gold mines, with 16,500 and 15,000 workers. These numbers suggest a substantial move of workers from 3T to gold, as commodity prices and demand for 3T have declined substantially. (p. 15)

- "The apparent shift of artisanal miners from 3T to gold and the current scale of artisanal gold mining have important consequences for the financing of armed groups and criminal networks. The wide availability of gold throughout the DRC, including in very remote areas, means that armed groups wishing to mine, trade, or tax gold to finance their activities have many opportunities, not least because the country's artisanal gold production is exported almost entirely unrecorded." (p. 16)

- The IPIS report cited DRC Official estimates of 6,112 kg of gold produced in 2013, with only 293 kg arising from artisanal production. IPIS' visual observations during their survey periods suggested the actual artisanal production could be in the range of 7,000 to 9,000 kg. This dwarfs the official estimate of artisanal production – indeed, it is substantially more than the better-monitored industrial production. This is another indicator that virtually all of artisanally-mined gold is smuggled out of the country. (p. 20)

- The OECD report also presents the official production figures from 2006 to 2013. The officially-reported production of gold more than doubled between 2012 and 2013. The 2013 number is a 20-fold increase over 2011, and a 40-fold increase over 2010. (p. 20, p. 44)

- IPIS visited 96 sites that were attended by two or more different armed actors; 89 of these were gold sites. (p. 22)

- Non-state armed groups' presence was virtually equivalent to that of Congolese public security forces at mine sites surveyed in 2013/14. With a presence at 304 sites, these groups continue to benefit from mining activities whilst also being responsible for serious human rights abuses, including in the course of perpetrating incursions on mining areas. One in four artisanal workers is engaged at a mine subject to armed group interference. (p. 29)

- IPIS data gathered on conflict financing at mines in 2013/14 was more developed than the 2009/2010 effort. Illegal taxation formed the overwhelming majority of armed interference at 504 cases identified, with involvement in the trade (92 cases) and digging for minerals directly (52 cases) also identified. Forced labor was identified in 46 instances. (p. 34)

- Over the three cycles of pilot implementation of the 3T supplement to the OECD Due Diligence Guidelines, IPIS observed a shift in attitudes to due diligence in the DRC from one of skepticism towards one of growing engagement. This appeared to have been spurred in part by the enactment of Dodd-Frank, changes in the DRC's regulatory framework, and industry requirements imposed through initiatives such as the Conflict-Free Smelter Initiative and iTSCi. (p. 35)

- IPIS noted industry-sponsored developments. Solutions for Hope was launched as a pilot initiative in July 2011, and gained traction as other global companies joined. KEMET established the "Partnership for Social and Economic Sustainability" in early 2012 as a mechanism to source conflict-free tantalum. From 2012 to 2014, the Dutch government partnered with Philips and Tata Steel to establish the Conflict-Free Tin Initiative in South Kivu province. These types of initiatives have seen the return of former large buyers to source from the DRC in accordance with OECD due diligence. They have also stimulated interest in localized processing of minerals, with construction of two smelters. (p. 36 – 37)

ABOUT THE AUTHOR

Douglas Hileman, CRMA, CPEA, P.E. has led his own firm for over seven years. He draws from over 35 years of experience in many aspects of operations, compliance, business strategy, enterprise risk management, non-financial reporting, audit readiness, and auditing. He worked at PricewaterhouseCoopers for six years, where he supported financial audits, internal audits, and other engagements involving governance, risk management, compliance. He also has nine years of experience in industry.

Douglas commented on the draft SEC Rule for conflict minerals. He has worked with clients in Advisory and Assurance roles for conflict minerals. As an advisor, he helped incorporate elements of other compliance and risk management frameworks into conflict minerals programs, anticipating inquiries from customers and senior management. His firm conducted one of the first four Independent Private Sector Audits (IPSAs), submitted for the 2013 reporting period. His firm was one of only three firms based in the U.S. to conduct IPSAs for the 2014 reporting period.

He is active in the Institute of Internal Auditors. He holds credentials as a Certified Risk Management Assurance professional (CRMA), Certified Professional Environmental/ Health & Safety Auditor (CPEA, Management Systems focus), Professional Engineer (chemical), and a Qualified Environmental Professional. He has taught "Incorporating Sustainability into Financial Reporting" at UCLA Extension. His firm serves clients nationwide from Los Angeles.

See www.DFCMAudit.com for more resources on IPSAs and related aspects of conflict minerals.

See www.douglashileman.com for more resources on environmental, safety, non-financial reporting, compliance, and risk management.

Find Douglas Hileman on Linked In.