



## SUSTAINABILITY FOCUS

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# THE APPROACH TO CONFLICT-FREE MINERALS FOR AUTOMOBILES AND HARDWARE COMPANIES

### KEY TAKEAWAYS

The great majority of North American Automobile and Hardware companies report publicly on conflict minerals, stimulated by the Dodd-Frank Act (Section 1502).

No controversies were observed, yet, against Automobiles and Hardware companies that did not disclose their compliance with the Dodd-Frank Act (Section 1502).

Some Hardware European companies (Philips, Alcatel-Lucent, Ericsson, etc.) and some Automobile Asia-pacific firms (Toyota Motor Corp., Nissan, and Honda) appear to also adopt initiatives and publish a Conflict Minerals Report, despite the absence of associated mandatory requirement in their respective regions, probably fostered by their operations in the United States.

Sector-driven initiatives and stakeholders' mobilisation appear as emerging drivers for fostering corporate actions to tackle the conflict-free minerals challenge.

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## INTRODUCTION

The extent to which transnational companies should be held responsible for human rights breaches in their subsidiaries or supply chain is obviously on the agenda of regulators. The European Parliament recent vote to **enforce an obligatory monitoring system for the whole supply chain of conflict minerals** was welcomed as a surprising run counter to the initial voluntary based proposal submitted by the European Commission. Heavy negotiations at European level are expected in the next months on this issue, echoing to the debates raised in France in the beginning of the year over the proposed bill on due diligence and the liability of parent companies in ensuring that their subcontractors comply with fundamental rights.

For more than a decade, Vigeo has scrutinised companies' practices to prevent child and forced labour, discriminatory practices, health and safety breaches, abusive working hours, union busting throughout their supply chain. For some sectors, such challenges materialise as well through specific issues as the conflict-mineral case perfectly illustrates.

This study aims at illustrating, through our observations of multinationals' approach on conflict-minerals, drivers for changes in companies' integration of CSR issues in their daily activities.



## BACKGROUND

**Conflict minerals sourcing** is a challenge for many companies that use minerals acquired through their supply chains. Conflict minerals refer to four main minerals (called 3TG): tin, tantalum, tungsten, and gold. These minerals can be mined in the conflict-torn Great Lakes region of Africa, and in particular, in the Democratic Republic of the Congo (DRC). Armed groups engaged in mining operations

in the region are believed to be involved in human rights abuses and financing regional conflicts.

The 3TG are key components of many everyday products belonging to various industries, including **electronics and communications, aerospace, automotive, jewellery and heavy manufacturing.**

Mineral	Metal	% world-supply from DRC	Main industries	Common applications
Cassiterite	Tin	5%	Electronics Automotive Industrial equipment Construction	-Solders for joining pipes of steel -Tin plating of Steel -Alloys (bronze, brass, pewter) -Packaging
Wolframite	Tungsten	3%	Electronics Lighting Industrial machinery	-Metal wires, electrodes, electrical contacts -Heating
Coltan	Tantalum	15-20%	Electronics Medical equipment Industrial tools and equipment Aerospace	-Capacitors (electronic products) -Carbide tools -Jet engine components
Gold	Gold	2%	Jewellery Electronics Aerospace	-Jewellery -Electric plating and integrated circuit -Wiring

Sources: (1) SEC Release No. 34-63547; File No. S7-40-10

(2) U.S. Geological Survey, Mineral Commodity Summaries, February 2014 – p66-67, 110-111, 168-169, 174-175

The DRC is considered as one of the richest countries in terms of natural resources: underground resources (untapped deposits of raw mineral ores, including cobalt, diamonds, gold and copper) are estimated at USD 24 trillion<sup>1</sup>. Yet, the country ranks among the poorest nations (GDP per capita of USD 412 in 2014<sup>2</sup>), due, in part, to the continuous conflict in the Great Lakes region (over 5.4 million dead from war-related causes since the early 1990s<sup>3</sup>). The extraction activity in

the area relies on artisanal and small scale mining, meaning that the livelihood of a significant share of the local population depends on minerals' trade.

In the context of increasing scrutiny by media and NGOs on conflict minerals, and in order to protect the weak economy of this region, public initiatives have been taken to allow generating income by local communities through a responsible sourcing of minerals.

1 Forbes.com website – accessed in May 2014 – <http://www.forbescustom.com/EmergingMarketsPgs/DR CongoP1.html>

2 IMF World Economic Outlook Database, January 2015

3 Enough Project – accessed in October 2014 – <http://www.enoughproject.org/category/conflict-area/eastern-congo>



## THE CHALLENGES OF SOURCING CONFLICT-FREE MINERALS FOR MULTINATIONALS

Conflict minerals can pass through many hands before becoming a part of the final product, **making it difficult to trace their origin.**

Several actors are indeed involved throughout the supply chain, including miners, traders, exporters, smelters, refiners, and alloy producers, raising concern over the capacity to ensure the respect of international social and environmental standards by each actor of this long supply chain. Press activists and other stakeholders, including Non-Governmental Organisations have been investigating this conflict minerals sourcing in the DRC region, revealing critical cases of sexual violence and the use of child soldiers in sourcing minerals<sup>4</sup>.

Due to a global spotlight on the issue, companies **are under scrutiny** from human rights activists, non-governmental organisations, investors, consumers or other

market forces to prove they are conflict-free. The European Union has started a regulatory process to frame this challenge, while issuers subject to the Dodd-Frank Act have to comply, without which they would be subject to **legal** liability as explained under Section 18 of the Exchange Act of 1934, if they do not comply in good faith<sup>5</sup>. This is a strong challenge for their capacity to preserve their reputational capital.

Considering the conflicts occurring in such regions, the risks of breaks in supply for companies that would not have enough insight into their supply chain to know whether their products are conflict-free could hamper their **operational efficiency**.

Compliance with the Dodd-Frank Act rule and the implementation of innovative initiatives that go beyond what is required by law are seen as good bases for multinationals to better mitigate these ESG risks.

## FROM VOLUNTARY INITIATIVES TO MANDATORY REQUIREMENTS

**Some industries particularly exposed to the challenge have initiated some years ago programmes to tackle the issue.**

The Electronic Industry Citizenship Coalition (EICC) and the Global e-Sustainability Initiative (GeSI) have developed a **certification process to identify conflict-free smelters**. There are a few hundred smelters around the world, a number which is easier to manage compared to the much larger number of mines. An independent third-party evaluation of smelters' procurement activities is conducted to conclude if these smelters

demonstrated that the material they processed originated from conflict-free sources. To date, a majority of certified conflict-free smelters are found in China, Malaysia, Russia, the U.S. and Indonesia<sup>6</sup>. supply chain via an Excel based Reporting Template.

The **Conflict-Free Sourcing Initiative (CFSI)** was launched in 2008 through collaboration between the GeSI and the EICC. The CFSI is one of the main voluntary initiatives in the electronics industry tackling conflict minerals issues in the supply chain<sup>7</sup>.

4 Information Technology Industry (ITI) website - accessed in July 2014 - <http://www.itic.org/policy/conflict-minerals>

5 "SECURITIES EXCHANGE ACT OF 1934" - Securities Exchange Commission - August 2012 - p284-285

6 "EICC-GeSI Conflict-Free Smelter Program: Smelter/Refiner Introductory Training & Instruction Document" - Electronic Industry Citizenship Coalition & Incorporated and Global e-Sustainability Initiative - April 2012 - p4

7 CFSI website - accessed in November 2014 - <http://www.conflictreesourcing.org/about/>



The CFSI includes the Conflict-Free Smelter (CFS), which aims at providing Information and Communication Technology (ICT) companies with information on smelters and refiners in the metals supply chain to promote a responsible sourcing of minerals<sup>8</sup>. The CFS programme is based on an independent third party audit of smelters' activities to be able to identify whether the metals processed come from conflict-free sources. The results are disclosed to be used by companies for their due diligence. Also, through the **Conflict Minerals Reporting Template** (CMRT), the CFSI helps companies to gather information on minerals in the supply chain via an Excel based Reporting Template.

While the majority of ICT companies in North America adhere to the Conflict-Free Initiative, Japanese companies appear to participate to the Japan Electronics and Information Technology Industries Association (JEITA). This latter has a Conflict Minerals provision that aims at stopping the source of financing for armed groups that profit from illegal trading of minerals mined by local people with the use of violence<sup>9</sup>.

The **Extractive Industries Transparency Initiative (EITI)** assesses the levels of transparency around countries' oil, gas and mineral sources management<sup>10</sup>. The EITI standard consists of a set of requirements that governments and companies have to adhere to in order to be considered an EITI compliant. The standard also covers license transparency, transit and state oil sales.

**Some governments and investors are regulating the supply of minerals, in order to ensure that companies are being transparent on their sourcing of conflict-minerals. Public initiatives form a legal framework for**

**transparency and can be considered as risk mitigation tools by concerned parties.**

On July 21, 2010, the United States Congress adopted legislation that requires public companies to report on the use of specific conflict minerals in the DRC and nine adjoining countries<sup>11</sup>, through the **Section 1502 of the Dodd-Frank Act**. By increasing transparency on the use of conflict minerals, this rule aims to dissuade companies from illegal sourcing of natural resources.

On August, 22, 2012, the US Securities and Exchange Commission (SEC) issued a final rule related to Section 1502 of the Dodd-Frank Act. The first specialised disclosure reports were expected to be filed by May 31, 2014, and companies already filed their first reports for the year ended December 31, 2013, following three main steps in the disclosure process:

1. Issuers are required to determine whether they manufacture or contract to manufacture products containing conflict minerals, and if it is the case, whether these minerals are essential components of the products. Only companies estimating that conflict minerals are necessary<sup>12</sup> for their products are subject to the SEC's disclosure rule.
2. Issuers sourcing necessary conflict minerals are expected to conduct a "reasonable country of origin inquiry" (RCOI) regarding the used minerals to determine whether minerals that are not from recycled or scrap sources originated in the covered countries. Issuers that use minerals coming from recycled or scrap sources are required to fill-in a special transparency report to briefly describe the RCOI used to determine the origin of these minerals. Such issuers are not concerned with the following step (3).

9 JEITA website - accessed in October 2014 - <http://www.jeita.or.jp/english/about/what/index.htm>

10 EITI website - accessed in October 2014 - <https://eiti.org/eiti>

11 Central Africa Republic, South Sudan, Zambia, Angola, the Republic of the Congo, Tanzania, Burundi, Rwanda and Uganda.

12 Conflict minerals are used in the production process but are not part of/ included in the finished product.



3. Issuers falling under the scope of the SEC rule are asked to apply a nationally or internationally recognised<sup>13</sup> due diligence framework. The aim of this due diligence is to determine whether minerals used by issuers are conflict-free (and therefore did not, directly or indirectly, finance or benefit armed groups in the covered region).

Issuing a specialised disclosure report or Conflict Minerals Report (CMR) normally involves a commitment to compliance with all applicable laws and regulations, the description of Reasonable Country of Origin Inquiry (through the EICC-GeSI Conflict Minerals Reporting Template), due diligence, audits, the mapping of the supply chain to smelter or refiner level, and in some cases the description of products containing 3TG metals.

On May 20, 2015, the **European Parliament** voted for a strong and binding law that requires companies trading in or using conflict minerals in their products to source responsibly<sup>14</sup>. This new initiative went past the voluntary proposal made by the European Commission in March 2014, which was described as weak in a joint statement sent to the European Commission, the European Parliament, and the European Council, by a number of global sustainable and responsible investors and investment organisations. These stakeholders urged the European legislative bodies to make the regulation mandatory and to include in its scope all companies that manufacture products containing conflict minerals<sup>15</sup>.

## VIGEO'S FINDINGS

The conflict minerals sourcing theme represents a challenging issue for companies that use minerals acquired through their supply chains. This constitutes a human rights challenge in many sectors covered by Vigeo. A focus on practices observed in Vigeo's Automobiles and Technology-Hardware sectors, exposed to this challenge, enables to draw a picture of efforts conducted by companies on this specific topic.

The management of social challenges in companies' supply chain and of responsible sourcing of minerals in particular is analysed by Vigeo in a criterion assessing the **level of**

**incorporation of social factors in their relations with suppliers and contractors.** More specifically, we analyse for the most exposed sectors the existence of a specific commitment to responsible sourcing of minerals, whether the company is a signatory of the conflict-free minerals sourcing initiative, the nature of **due diligence** measures reported (tracking/tracing company sourcing, certification of chain of custody by a third party, transparency and cooperation with stakeholders) and the existence of audits evaluating smelter' procurement activities.

<sup>13</sup> Complying with Generally Accepted Government Auditing Standards (GAGAS).

<sup>14</sup> "EU Regulation on conflict minerals: What the European Parliament vote means for member states" -

<sup>15</sup> Amnesty International & Global Witness - June 2015 - p1

"Group of Investors Urge European Union to Adopt Stronger Conflict Minerals Legislation" - Eurosif - 21/10/2014



## Vigeo's findings – Transparency on conflict-minerals in the Automobiles sector

### Percentage of Automobile companies reporting publicly on conflict minerals



As evidenced by the histogram above, there is a greater percentage of **North American Automobile companies** reporting publicly on conflict minerals, induced by Section 1502 of the Dodd-Frank Act. Companies based in North America already have to file a financial report annually to the SEC, and are therefore subject to filing a report on conflict minerals, but we can observe that not all of them are respecting this mandatory requirement. Vigeo did not observe, as of today, any controversies or actions led against these non-compliant companies.

In the **Asia Pacific** sector, the only companies to cover this topic publicly are large automobile manufacturers with a big presence in North America (e.g. Toyota Motor Corp., Nissan, and Honda).

The legal aspect of conflict sourcing of minerals does not appear to be still mature for **European** companies, despite the moving

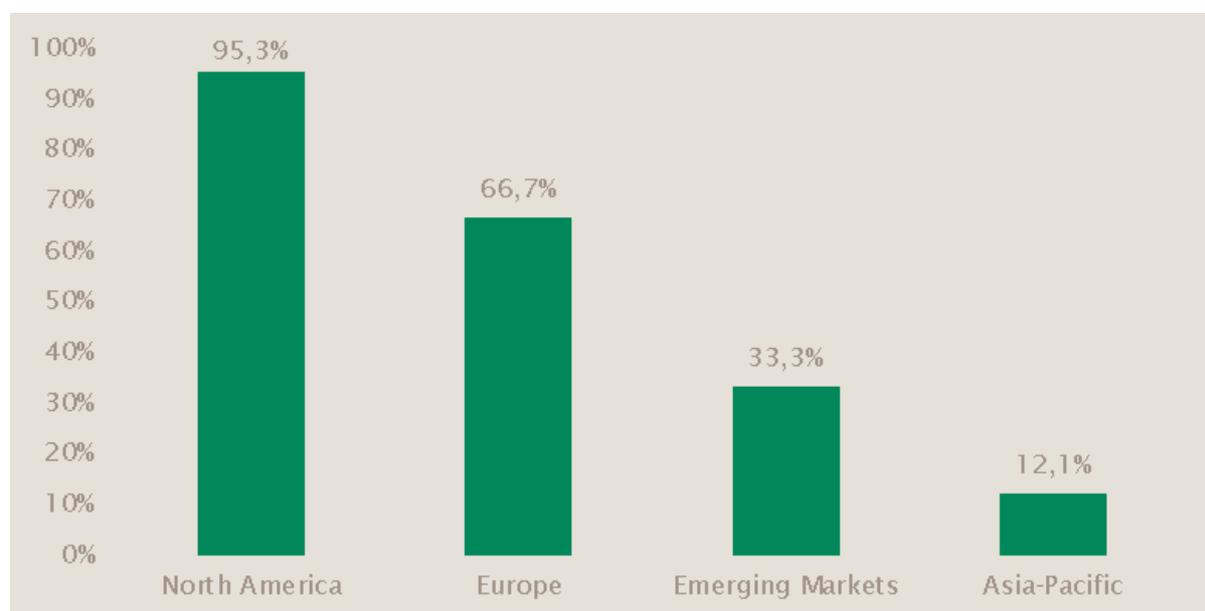
regulatory environment and stakeholder-voluntary initiatives on this topic. Their lower transparency compared to other zones can also be explained by the fact that they do not have direct operations in the United States, which enables to highlight the leverage effect of national regulations impacting multinationals over worldwide practices.

The zone with the poorest level of disclosure on conflict minerals is the **Emerging Markets** area. Companies in the Emerging Markets have operations mainly in the country where they are headquartered, and thus may not feel the same pull from the legislation to communicate on conflict minerals in their supply chain.



## Vigeo’s findings – Transparency on conflict-minerals in the Technology Hardware sector

### Technology–Hardware Sector Public Disclosure on Conflict Minerals per Region



The Technology Hardware sector is particularly exposed to the conflict-mineral challenge and has launched voluntary initiatives over the past years.

The observed practices in this sector demonstrate a higher maturity of issuers on the issue, which was illustrated in the conclusions of Vigeo’s recent update of the North America Technology–Hardware sector, composed of 41 companies.

As represented in the graph above, almost all **North American** Hardware companies in Vigeo’s universe do provide public reporting on conflict minerals. In line with the Automobiles sector, this is mainly driven by the legal obligation in the United States to submit a Specific Disclosure Report to the SEC on conflict minerals sourcing.

### April 2015 findings related to Conflict–Free Minerals sourcing issue in the Technology–Hardware North America Sector

Observed initiatives in the Technology–Hardware North America Sector	Share of companies reporting such initiatives
Signatory of Conflict–Free Minerals sourcing initiative	80.5%
Commitment to responsible sourcing of minerals from conflict areas	85.4%
Due Diligence	95.1%
Chain of custody tracking/ tracing	53.7%
Certification of chain of custody by third party	7.3%
Transparency (CMR/ answering customer inquiries)	41.5%
Cooperation with stakeholders	43.8%
Audits evaluating smelters’ procurement activities	12.2%



A majority of companies constituting Vigeo's Technology Hardware North America sector provide evidence to actively tackle the conflict-mineral challenge. The previous table presents the measures observed in our latest review of the sector in April 2015.

In the **European** region, two-thirds of the companies in Vigeo's universe appear to adopt initiatives and publish a CMR. This can also be explained by the fact that many European companies have operations in the United States (e.g. Philips, Alcatel-Lucent, Ericsson, etc.).

In the **Emerging Markets** region, 33% of the companies published a CMR while 52% of them appeared to take initiatives to stop sourcing conflict minerals (e.g. LG Electronics Inc., Samsung Electronics Co., etc.).

**Asia-Pacific** is the region with the lowest level of disclosure on conflict minerals: only 12% of the companies in Vigeo's universe did publish a CMR but 42% of them appeared to take initiatives to stop sourcing conflict minerals (e.g. Canon, Panasonic, Sony, Toshiba, etc.).

One of the companies leading the way on this issue in the Technology-Hardware sector is

**Intel Corp.**, which announced in January 2014 an open target to manufacture microprocessors that are 100% free from conflict minerals starting from 2014. Intel's microprocessors are considered to be the first completely conflict-free products in the electronics industry. According to **Intel**, conflict-free microprocessors will be validated as not containing minerals (tantalum, tungsten, tin and gold) from mines that pass their profits to armed groups in the DRC and other mineral-rich areas of the African Great Lakes region.

The share of Technology-Hardware companies identified as at risk due to their lack of disclosure in an existing or strengthening regulatory environment is low for American companies (4.6%) and limited for European companies (33.3%). The share of companies that are potentially exposed to reputation or operational risks for non-compliance with the law on conflict minerals sourcing is significant for Emerging Markets companies (66.7%) and major for Asia-Pacific firms (87.9%). Vigeo still did not detect any controversies or actions directed against such non-compliant companies in the four covered areas.

## CONCLUSION

Our analysis enabled to illustrate the positive influences that regulatory frameworks, stakeholders' coalition and industry-driven voluntary initiatives can play on multinationals: companies reporting on conflict minerals sourcing in regulated areas take the leader role and influence company behaviours in other areas. Stakeholders' coalitions in Europe made the Parliament strengthen a bill that was initially framed on voluntary bases. The ICT sector that initiated several years ago voluntary initiatives is now leading the way; thus representing tools to align practices and the regional framework

regarding this topic.

Our analysis focused on the specific challenge of human rights violations in and around mines in Congo that some sectors have to tackle out of many other social risks existing in supply chain. Vigeo also analyses the level of integration in companies' supply chain of other social requirements, such as abolition of child and forced labour, non-discrimination, health and safety, decent wages and working hours, and the right to freedom of association and collective bargaining.



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