



## OECD PILOT PROJECT IN THE MINING AND MINERALS SECTOR

### **Draft due diligence guidance for responsible supply chain management of minerals from conflict-affected and high-risk areas**

Expert meeting of the OECD hosted working group

April 28, 2010

*Summary Report*

*The expert meeting was conducted under Chatham House Rules (no attribution of remarks to individuals or organisations).*

#### **I. Introduction**

The expert workshop was convened to review the working draft due diligence guidance for responsible supply chain management of minerals from conflict-affected and high-risk areas (hereafter “the draft guidance”).

The draft guidance has been developed as part of the OECD Pilot Project in the Mining and Minerals Sector, a joint work by the OECD Investment Committee and Development Assistance Committee to clarify private sector responsibilities in conflict-affected and high-risk areas on the basis of the *OECD Guidelines for Multinational Enterprises* (hereafter the “*MNE Guidelines*”) and the *OECD Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones* (hereafter the “*Risk Awareness Tool*”).

The rationale for the draft guidance is that companies are expected to perform due diligence for responsible supply chain management of minerals from conflict-affected and high-risk areas in order to discharge their corporate responsibilities and prevent or manage the adverse impacts associated with the mineral extraction, trade and handling in these areas.

Minerals extracted, traded and handled in conflict-affected and high-risk areas are associated with financing parties to the conflict, corruption, financial crime, fraudulent misrepresentation of country of origin and chain of custody, tax evasion and violations of human rights, labour rights and international humanitarian law.

Risk-based due diligence in the supply chain refers to the company efforts to clarify its chain of custody and the qualitative circumstances involved in the mineral extraction, trade and handling in order to identify and manage actual, potential or perceived risks of harm associated the activities and relationships of all upstream actors with a view of avoiding adverse impacts.

The draft guidance adopts this risk-based due diligence definition and outlines five practical due diligence steps for responsible supply chain management of minerals from conflict-affected and high-risk areas: (1) strengthen company management systems, including chain of custody tracking system over the mineral supply chain; (2) identify facts and assess risk in the supply chain; (2) design and implement mitigation strategies by establishing improvement plans or discontinuing engagement with suppliers; (4) ensure independent third-party audit; and (5) report on supply chain due diligence and findings.

The one-day expert meeting was divided into six sessions which closely followed the structure of the draft guidance. A wide range of stakeholders, including interested members of the OECD hosted working group, attended this event. Participants included OECD and African countries, international organisations, regional organisations, metal traders and suppliers, smelters and processors, host state industry organisations, international industry organisations, brand end-users, civil society organisations, expert consultancy groups and independent experts.

## **II. Objectives**

The meeting aimed to review the structure and content of the draft guidance for the purpose of getting expert input for the final draft.

Specific objectives for the sessions included:

- Agree upon (i) the definition of due diligence in the supply chain, (ii) the risk-based approach adopted in the guidance, (iii) the distinction between companies handling mineral concentrate and companies using refined metals in Step 1 and Step 2, and (iv) the proposed five procedural steps as articulated in the draft guidance.
- Agree on common standards and brainstorm on improvement plans with step-wise improvement indicators to be adopted as part of a company's risk mitigation strategy (*Step 1(A) and Step 3*).
- Comparatively analyse chain of custody tracking, traceability systems and internal controls and recommend best practices to be included in the revised draft (*Step 1 (C)*).
- Highlight practical challenges for company's undertaking risk assessments of the supply chain and preliminarily identify ways of overcoming the challenges (*Step 2*).
- Review independent third-party audit recommendations, suggesting methods for overcoming potential challenges to auditing practices such as audit costs and audit fatigue (*Step 4*).
- Unpack the reporting obligations of companies, taking into account confidentiality issues related to commercially sensitive information in the mineral supply chain, noting differences in reporting on the company due diligence practices and other disclosure requirements provided under the MNE Guidelines and EITI.

Guiding questions were posed to the participants in a separate document to inform the discussion and meet these objectives.

## **III. Summary Conclusions**

*Participants strongly endorsed the draft guidance.* Participants recognised the added-value of this guidance since it provides a global framework on responsible supply chain management of conflict minerals encompassing all actors involved, beyond mineral, country or regional-specific initiatives. Participants also highlighted that the draft guidance would play the key role of bringing together and clarifying standards for international corporate supply chain management, thus providing a coherent and comprehensive framework for specific implementation initiatives. Benefits include: reduce costs for the business community, harmonisation of approaches and the provision of clear expectations of corporate behaviour across the entire supply chain.

*The participants agreed on adopting the overall framework provided in the draft guidance, specifically the definition of risk-based due diligence in the supply chain and the 5 practical steps. It was clarified that additional analytical work would be undertaken to address the specific concerns of participants on specific aspects within each due diligence step (see below).*

One participant expressed reservations in adopting all the steps for all actors in the supply chain, noting in particular the costs of auditing. Another participant worried that due diligence in the supply chain of minerals from conflict-affected and high-risk areas may eventually be too cumbersome for companies, highlighting that the tin industry was relatively small and if due diligence costs were driven too high then companies may discontinue supply from eastern DRC. *It was agreed that while auditing was a fundamental aspect of due diligence, further work should be undertaken to refine and clarify the auditing recommendations in the guidance.*

Due to time constraints, the workshop was unable to explore specific risk mitigation strategies that could be used by companies in areas of artisanal mining & mining conditions, involvement of parties to the conflict and corruption & financial crime. *It was agreed that the OECD Secretariat, with support from experts and members of the OECD-hosted working group, would undertake further work to develop clear risk mitigation strategies.*

Some participants questioned the role of governments in the draft guidance and noted that the document could benefit from further recommendations on how companies should engage with local governments and institutions to identify and manage risks. It was noted that the guidance already recommends companies take advantage of government efforts to map militarized mines. *It was clarified that the guidance would complement and support host government and regional efforts to strengthen capacity and the regulatory and enforcement environment associated with mineral extraction, trade and handling. It was further clarified that company engagement with host country institutions and local civil society would be included into the risk mitigation strategies to be developed.*

#### **IV. Summary of Main Issues:**

##### **a. Object, scope and structure of the guidance**

Participants noted that “risk” was already an intuitive concept for companies, which should make risk-based due diligence for responsible supply chain management familiar territory.

Some participants questioned the merit of qualifying “due diligence” as “enhanced”. *It was clarified that the guidance outlined due diligence for companies sourcing minerals from conflict affected or high risk areas, which, because of the objective context of mineral extraction, trading and, handling, present higher risks of adverse impacts. The term “enhanced” was intended to capture the need for companies to tailor due diligence efforts to the specific factual circumstances and extra difficulties presented by conflict-specific risks. Since there was a shared understanding of the need to contextualize the performance of due diligence, it was agreed that any further qualification would be unnecessary. This would also allow to align the definition of due diligence with that provided by the Special Representative of the UN Secretary-General on human rights and transnational corporations and other business enterprises, Prof. John Ruggie.*

*Participants agreed with the distinction drawn in the guidance between upstream and downstream companies (“companies handling mineral concentrate” and “companies using refined metal”), noting that the mineral smelters represented an obvious choke point at which to differentiate chain of custody tracking and internal controls over the mineral supply chain. Some participants however felt that more than two layers would be needed and that further nuanced guidance may be necessary for end-users, smelters and export houses, in particular with regard to auditing requirements.*

With regard to the terminology used to draw the distinction between “companies handling mineral concentrate” and “companies using refined metal”, one participant noted that the term “mineral concentrate”, could be potentially misleading, as raw ore requires preliminary processing before it is considered concentrate. It was suggested that the guidance use a more appropriate term that accurately encompasses all upstream companies. *However it was clarified that artisanal miners concentrate raw ore in a rudimentary way before selling to intermediaries downstream, and therefore the term “companies handling mineral concentrate” accurately captures all upstream actors in the supply chain.*

#### **b. Common standards and improvement plans**

There were discussions on whether the scope of the standards and risks dealt with in the guidance document should be restricted to only those risks associated with contributing to conflict, as opposed to including wider standards on risks associated with conflict-affected and high-risk areas in general, such as child labour, unsafe and unhealthy working conditions and informal and artisanal mining. *Most participants however noted that risks associated with contributing to conflict are interdependent with these other risks, and therefore require equal consideration in the guidance.* One participant also suggested adding a section on environmental concerns to Annex I in the draft guidance. Another participant suggested that “fiscal considerations” should be included as a separate section of the standards, noting that issues such as paying taxes were not limited to artisanal mining.

Some participants noted that clear principles should be established, upon which companies would determine their own risk and decide whether or not to engage. *One participant cautioned against entering into discussions on the acceptability and unacceptability of specific factual circumstances. Another participant agreed and explained that companies would always face dilemmas which would need to be decided on a case-by-case basis.*

On risk mitigation, one participant highlighted that the guidance should stress the dynamic nature of risk mitigation, and that a company may decide to resume engagement with suppliers after excluding them from their supply chains if the company shows improvement. *It was clarified that the guidance would capture this dynamic aspect of due diligence.* Another participant suggested prioritizing issues for improvement and that companies should establish lists of “good” suppliers to whom they pay a premium as a strategy for risk mitigation. It was also suggested that companies should be required to remedy the harms that already occurred as a result of their activities and relationships.

One participant suggested that risk mitigation strategies should consider whether or not countries have made demonstrable improvements to their regulatory and enforcement environments, and therefore cautioned against the guidance adopting blanket recommendations for risk mitigation based on objective circumstances which do not consider host government efforts to build capacity and strengthen the regulatory environment. *It was clarified that a dynamic risk assessment necessarily considers host country efforts when determining risk.*

#### Involvement of parties to the conflict

*It was generally agreed that companies should disengage with suppliers if risk assessments reveal involvement of non-governmental armed groups in the extraction, trade or handling (including through taxation) of minerals.* However, one participant highlighted that parties to the conflict can exert control over mines, intermediaries and export houses in both direct and indirect ways, and that the guidance could benefit from clearer definition of what “control” means in these different circumstances.

One participant highlighted a possible distinction would be to refuse minerals if risk assessments reveal involvement of armed forces outside the integration process, but put in place mitigation strategies with a clear timeframe for continued engagement and improvement if risk assessments reveal involvement armed forces within the integration process. Some participants welcomed this distinction. Many participants noted however that qualitative assessment of the types of military involvement would still be necessary to avoid

legitimation of harmful activity. *It was clarified that the draft guidance preliminarily recommends that military involvement should be limited only to providing security.* This idea was welcomed, but participants noted that clear criteria should be elaborated for companies to easily identify what would qualify for “provision of security”.

### Artisanal mining and mining conditions

Participants debated the most appropriate way to approach the various factual circumstances on artisanal mining, highlighting the tensions between a company’s responsibility to obey the law, ensure the payment of appropriate taxes and prevent artisanal miners in their supply chain from exploitation on the one hand, with the need for constructive engagement to prevent a blanket embargo that would put artisanal miners’ livelihoods at risk on the other.

On formalisation and the requirement for artisanal miners to have the requisite licences and organisational structures, *participants generally agreed that a lack thereof should not lead to automatic disengagement by downstream actors, but rather to a risk mitigation strategy aimed at promoting constructive engagement with state actors, civil society and upstream companies.* In such cases, one participant noted that a long-term approach would be necessary, and recommended that the OECD-hosted working group considers the five year process which led to the establishment of the Standard Zero, referred to in Annex I. *It was agreed that clear principles on improvement, with step-wise improvement indicators would need to be developed.*

*Participants agreed that the failure of miners to pay appropriate taxes may be a cause for disengagement,* however participants noted that artisanal miners in DRC are usually taxed on sale downstream, where taxes are taken off the sale price before being formally taxed on sale to export houses. In such cases, one participant noted that export houses must not buy from intermediaries and traders that do not comply with the law, highlighting the difficulties if export houses discover through due diligence that their suppliers purchase from artisanal miners not in compliance with the law.

*On labour conditions in the mine, many participants felt that the worst forms of child labour and forced labour would be cause for disengagement with suppliers.* One participant explained that forced labour was not an issue in eastern DRC, while another responded that being forced to hand over one day labour is in fact a form of forced labour.

On the acceptability of other labour conditions, participants were undecided about whether and how to engage with suppliers to meet international and national standards. One participant suggested that the annexed standards should include standards on a living wage, the right to organise and address the casualization of work.

### Corruption and financial crime

It was agreed that the section on corruption and financial crime should cover the offer, promise, give, or demand a bribe or other undue advantage to obtain or retain business or other improper advantage as provided under the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the OECD Guidelines for Multinational Enterprises. The guidance will also draw on the United Nations Convention Against Corruption to cover corruption in the private sector. *It was clarified that bribery in any form is always unacceptable.*

One participant highlighted that the issue of risks related to “signing bonuses” should be covered by the guidance. In view of the corrosive effect of small facilitation payments, particularly on sustainable economic development and the rule of law, the OECD Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions adopted in November 2009 recommends that Member States should encourage companies to prohibit or discourage the use of small facilitation payments in internal company controls, ethics and compliance programmes or

measures, recognising that such payments are generally illegal in the countries where they are made, and must in all cases be accurately accounted for in such companies' books and financial records.

Participants also recommended to trace the financial flows resulting from mineral extraction, trade and handling in conflict-affected and high-risk areas. *Participants suggested that the Financial Action Task Force should engage with the OECD Secretariat to elaborate guidance on tracking financial flows, controlling cash payments, and preventing direct or indirect company involvement in money laundering and financial crime through their supply chains.*

### **c. Traceability systems and internal controls**

Throughout the expert meeting, participants queried how institutionalised traceability and/or certification systems fit into a company's due diligence efforts. *It was clarified that companies were expected under Step 1(C) to establish a chain of custody and the location and conditions of mineral extraction, trading and handling regardless of any institutionalized traceability system that may be in place. Institutionalised traceability systems may however help companies to partially discharge their responsibilities under Step 1(C).*

*Establishing a chain of custody, as well as the location and conditions of mineral extraction, trading and handling, is necessary but not in itself sufficient for companies to identify and manage risks and avoid adverse impacts in their supply chains. For example, companies must still undertake fact and risk assessments to confirm the findings of traceability and chain of custody information and identify additional risks which, by their nature, are unlikely to be caught by such systems (e.g. risks of mineral taxation along trade routes).*

*It was agreed that the International Conference on the Great Lakes Region would undertake a comparative analysis of the various mineral chain of custody tracking and traceability schemes (e.g. ITRI-iTSCi; BGR-CTC) for the purposes of recommending best practices to be incorporated in the draft guidance (Step 1(C)).*

One participant explained how existing digital information-sharing systems used by downstream companies to track supplier performance could be extended upstream to the smelter and provide a useful tool for downstream companies to establish internal control over the mineral supply chain, while concurrently reducing costs associated with audit fatigue and self-assessment fatigue.

### **d. Fact and risk assessment**

Participants highlighted many of the challenges for obtaining accurate information for effective risk assessments. In particular, one participant highlighted that it is possible to obtain all the necessary information for a risk assessment, including information on company shareholders and the behind the scenes actors exerting control over intermediaries and export houses, but that would require lengthy engagement by company assessors and independent auditors who would need to be extremely familiar with the socio-political landscape of eastern Democratic Republic of the Congo and the particular methods for obtaining information. *It was suggested that company assessors could obtain local expertise to overcome these challenges.*

*Drawing from supply chain efforts in other sectors, it was suggested that entire supply chain risk assessments be conducted every two years, but that companies conduct on-going monitoring and further risk assessments after change of circumstances. It was noted that the guidance could benefit from a clear list of red flags that would trigger such company risk assessments.*

It was further suggested that a risk assessment should *differentiate systemic from isolated risks, the former requiring mitigation strategies that necessarily include government bodies and local civil society. It was*

also noted that the guidance should include recommendations for companies to disclose these risks as part of their risk mitigation efforts, thereby establishing a productive and inclusive environment for governments, civil society and other interested stakeholders to engage with the company to reach sustainable solutions for risk mitigation.

#### **e. Independent third party audits**

The auditing step was thoroughly discussed by participants. Some participants cautioned that requiring audits of all a company's suppliers would be too costly and burdensome. *It was clarified that the draft guidance recommends each company to carry out an audit of its own due diligence practices for the purposes of accountability, transparency and improvement. Such audits may include in-site checks of each company's suppliers, but only for the purposes of cross-checking the company's actual due diligence practices against the processes and standards recommended in the draft guidance. These checks would therefore be limited to only those suppliers sourcing from conflict-affected and high-risk areas.* For example, as downstream companies are expected in the draft guidance to evaluate the due diligence practices of smelters and processors, in-site audit checks of the downstream company's suppliers would then be limited only to those smelters and processors sourcing from conflict-affected and high-risk areas.

One participant explained that a great deal of their upstream suppliers operating in conflict-affected areas (or countries neighbouring conflict-affected areas) were small two person companies. Conducting formal audits on these heavily dispersed and small companies would be difficult and impractical. *Drawing from experiences in other fields, it was clarified that in such cases where there are a large number of upstream suppliers sourcing from conflict-affected areas, the guidance would recommend audits be conducted on a sample of suppliers, determined on a risk-sensitive basis.* This would be particularly relevant for upstream companies, in relation to which further work would be necessary to find cost effective solutions to overcome these practical difficulties, including the elaboration of sampling guidance for a revised draft. It was also agreed that further work would be undertaken to overcome the potential audit cost burden and audit fatigue, *which may include ways of sharing audit costs through joint audits of suppliers at specific choke points in the supply chain.*

Participants questioned who would carry out the audits and how independence, accountability and transparency could be guaranteed by third party audits. *It was suggested that the OECD considers the feasibility of institutionalizing audit systems, with such a system housed at the OECD or elsewhere. Drawing on experiences in other sectors, it was noted that institutionalizing the audit system would reduce costs and add value by collating and sharing information generated by audits and other interested third parties.*

#### **f. Reporting**

The requirements for company disclosure were discussed at great length. Many participants called for downstream companies to fully disclose information on their suppliers including their identification and licensing records, and disaggregate information on mineral purchasing, including the origin, weight, quantity, purity and key chemical characteristics of the minerals, dates and methods of mineral extraction, transportation routes and all taxes and public fees paid throughout each stage of the supply chain (provided under Step 1(C)(ii) of the draft guidance).

Some participants resisted this recommendation, noting that aggregate statistics are already published, and when coupled with publicly disclosed auditing reports and mineral traceability and certification schemes, should be sufficient to achieve expectations on disclosure. *Participants highlighted the problem that aggregate statistics prevent a "smart" analysis of risk because they fail to identify risks associated with specific suppliers and areas during specific timeframes and are thus more likely to lead to blanket embargoes of whole regions and countries.*

Many participants also felt that a requirement to disclose the amount paid for each batch of minerals along the supply chain would be too far-reaching as this was commercially sensitive information. It was suggested that disclosure of these types of payment details could be delayed to 3-6 month instalments to prevent potential competitive disadvantages.

*Participants suggested that the guidance, if suitable, may wish to differentiate between that information which must be disclosed to downstream companies in order for them to carry out supply chain due diligence, and that information which must be disclosed to the public. At a minimum, disaggregate information outlined in Step 1(C)(ii) should be made available to downstream companies, without which these companies would be unable to conduct adequate due diligence.* This information must also be made available to auditors for them to effectively audit a companies' due diligence practices. It was noted that companies failing to disclose this information to downstream companies risk being excluded by those companies pursuant to their due diligence efforts. One participant highlighted that export houses were already providing all the information to downstream companies.

It was suggested that more work should be undertaken to analyse and elaborate public reporting requirements, drawing from the principles and criteria of EITI and other multi-stakeholder government—backed initiatives to ensure the credibility of the system.

#### **g. Additional considerations**

Participants considered whether and how the due diligence guidance could be extended to gold. *All participants agreed that the guidance should be extended to the special risks associated with the supply chain of gold from conflict-affected and high-risk areas.* One participant explained that the overall framework would apply to the gold supply chain, but that the detailed guidance on establishing traceability and internal controls, on carrying out fact and risk assessments, and on risk management would differ. Participants highlighted that gold presents special challenges for supply chain due diligence because very little is exported legally and there is hardly any paper trail, making the identification and management of risk extremely difficult.

#### **V. Next Steps**

It was agreed that the OECD-hosted working group in the mining and minerals sector would undertake the following work to inform the final draft of the guidance:

- Elaborate consolidated standards based on the list in Annex I and develop clear risk mitigation strategies in areas of artisanal mining & mining conditions, involvement of parties to the conflict and corruption & financial crime;
- Refine and clarify the auditing recommendations in the guidance, and undertaking a feasibility study on the institutionalisation of audits;
- Determine the applicability of the guidance to other minerals, in particular gold and elaborate any additional recommendations if necessary to ensure the draft guidance applies to supply chain management of gold from conflict-affected and high-risk areas;
- Determine the applicability of the guidance to minerals of industrial origin and elaborate any additional recommendations if necessary to ensure the draft guidance applies to supply chain management of minerals of industrial origin from conflict-affected and high-risk areas;
- Outline due diligence guidance for financial institutions to address the risks of illicit financing linked to the extraction, trade and handling of minerals from conflict affected and high-risk areas.

The OECD Secretariat would liaise with relevant members of the OECD-hosted working group to carry out this work. A finalized draft would be made available by early September, 2010 in view of the joint ICGLR/OECD conference in Africa to be held in the second half of September 2010.