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OECD Implementation Pilot Downstream Baseline Report - Detailed Discussion

OECD
Multi-Stakeholder
Forum
30 November 2011

Goals of today

- Provide detailed findings on the downstream baseline report
- Use this opportunity to answer questions and provide clarifications
- Generate a constructive discussion among all stakeholders
- Process:
 - First review pilot participants and discuss how to increase coverage
 - Next, go through on a Step by Step basis findings and challenges
 - After each Step, we have listed a few questions to facilitate discussion and surface practical solutions to move forward
 - Invite companies to share their own experiences with examples if they can

Downstream participation

Industry

Participants represent a range of industries:

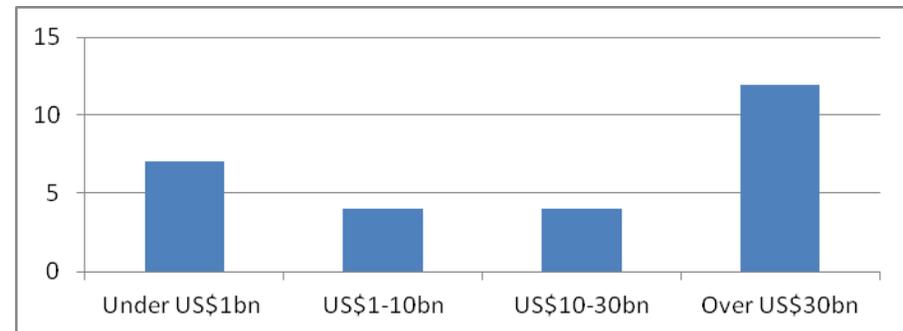
- Aerospace and defense
- Automotive
- Medical devices
- ICT (including semiconductors)
- Consumer products
- Extractives
- Chemicals
- Lighting

Missing industries:

- Jewelry
- Construction
- Pharmaceuticals
- Packaging

Revenues

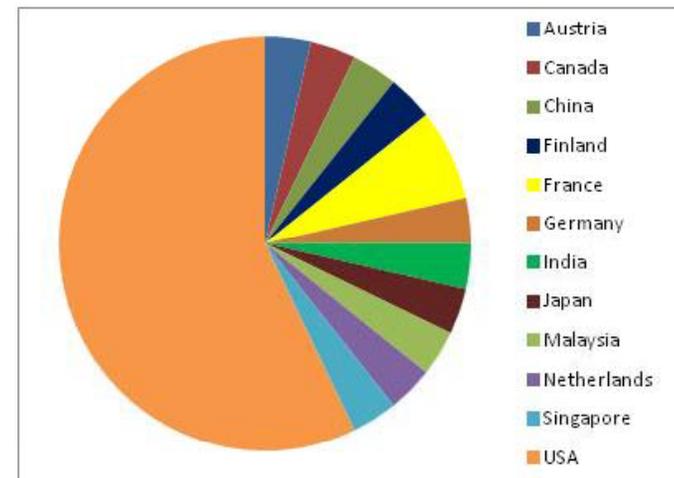
Companies ranged in size based on annual revenues earned in 2010. More than one third earn more than US\$30bn in revenue



Downstream participation

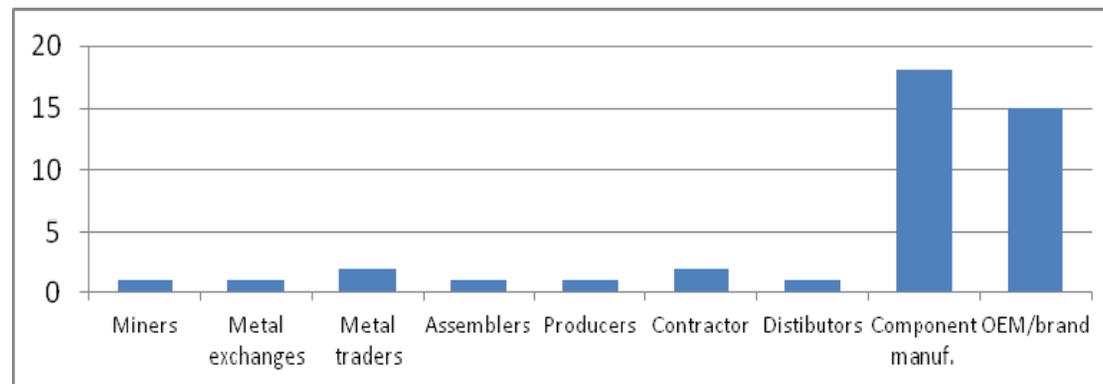
Geographical breakdown

- Participating companies are headquartered throughout the United States, Canada, the European Union, China, Japan, Malaysia, and Singapore
- Majority of companies based in OECD countries; 15% headquartered in non-OECD countries



Supply chain position

- Participants include metal traders, exchanges, component manufacturers, product manufacturers, original equipment manufacturers, and retailers.
- 8 companies are OEMs; 8 are component manufacturers
- 9 companies fall into multiple categories due to vertical supply chains



Current participants - disclosed

Companies	Industry Associations
<ul style="list-style-type: none">» Alcatel Lucent» Alpha (Cookson)» Boeing Company» Circuit Connect» Epic Technologies» Flextronics» Ford Motor Company» Foxconn» Freescale» General Electric Co., Lighting Division» Hewlett Packard» KEMET» Lockheed Martin Corporation» Nokia» Oracle» Panasonic Corporation» Plansee Group Service GMBH» Research in Motion» Royal Philips Electronics» Siemens» Texas Instruments» TriQuint» UNISEM	<ul style="list-style-type: none">» AIAG (Automotive Industry Action Group)» EICC-GeSI (Electronics Industry Citizenship Coalition and Global e-Sustainability Initiative)» IPC (Association Connecting Electronics Industries)

Discussion Themes

Theme 1: Involving relevant downstream industries

- How can all relevant downstream industries be involved in the implementation of the OECD Guidance?

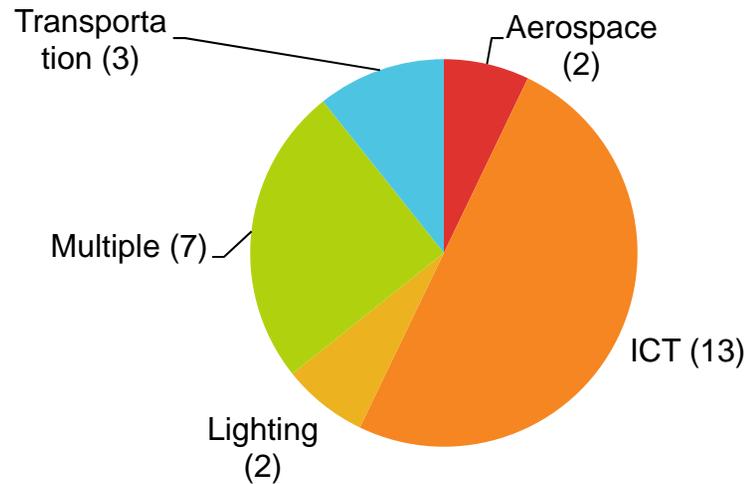
Theme 2: Ensuring balanced coverage of the supply chain

- How can sufficient and balanced coverage of all relevant parts of the supply chain be ensured?

Theme 1: Involving relevant industries

Current participants by Industry:

- Aerospace & Defense
- Automotive
- Chemicals
- Consumer products
- Extractives
- ICT
- Lighting
- Medical Devices



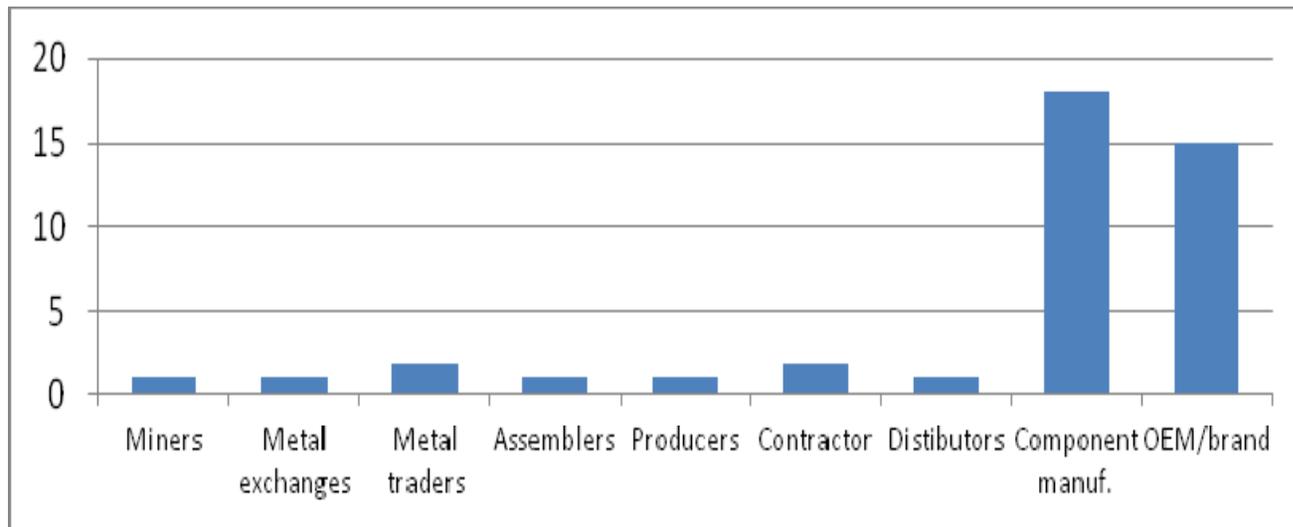
Consider role of:

- Industry Associations
- Stakeholders such as Socially Responsible Investors (SRIs)
- Participant disclosure

Theme 2: Balanced coverage of supply chain

Participants supply chain position

- Participants include metal traders, exchanges, component manufacturers, product manufacturers, original equipment manufacturers, and retailers



Consider role of:

- Using participants to recruit their Tier 1 suppliers (limited)
- Role of industry groups who represent multiple tiers
- Stakeholders in non OECD countries

Step by Step Discussion

Baseline Report Content

Questionnaires were used to determine participating companies' level of implementation of the OECD Guidance five-step framework:

- **Step 1:** Establish strong company management systems
- **Step 2:** Identify and assess risk in the supply chain
- **Step 3:** Design and implement a strategy to respond to identified risks
- **Step 4:** Third-party audit of smelters/refiners' due diligence practices
- **Step 5:** Report annually on supply chain due diligence

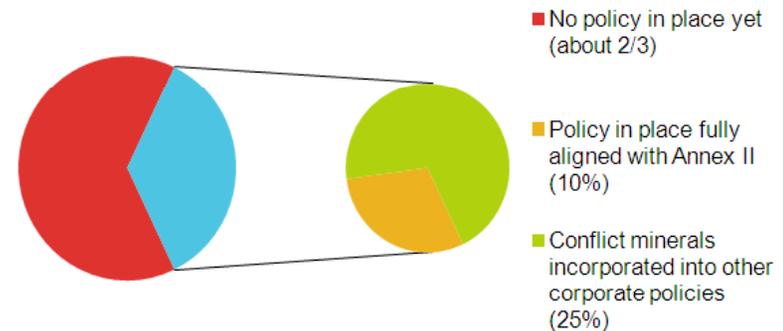
Step 1: Establish strong company management systems

Step 1.A: Adopt and commit to a supply chain policy

Policy

- 9 companies have a policy in place
- 6 out of the 9 companies described their policies as consistent with the OECD Guidance. Only 3 contain all of the elements of Annex II.
- 5 have stand-alone policies, while four integrated into broader policies or codes of conduct

Degree of policy development



Reasons for not having a policy

- Policies still in development
- Internal approval and/or legal review
- Awaiting final ruling on the U.S. Dodd-Frank Act and/or other legislation such as the California Transparency Act of 2010
- Putting due diligence systems in place first

“We find it problematic to make commitments outside our sphere of control. We want our policy to be actionable. If topics are not covered by our direct activities or industry tools and schemes, we don't have control over them. It has also been a challenge to give clear directions to suppliers because while we want to avoid conflict minerals, we do not want to place an embargo on Central Africa.” —Pilot participant

Step 1.B: Structure internal management systems

Internal resources

- 19 companies dedicate internal resources
- 19 companies dedicate senior-level responsibility
 - Five delegate responsibility at vice president level
- Dedicated teams are made up of cross-functional staff
- Staff generally spend 5-20% of their time

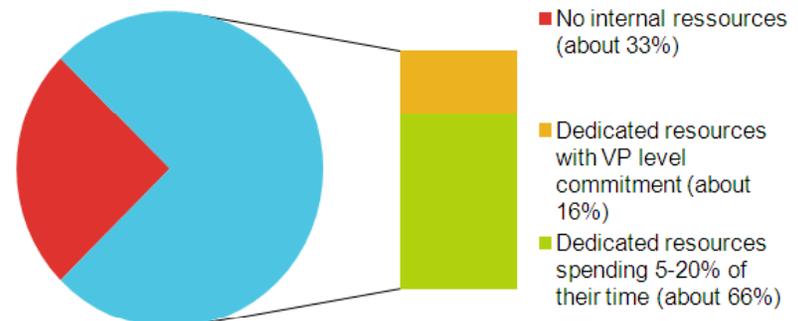
“The program manager reports program performance and metrics on a quarterly basis to three Senior VPs in product manufacturing and VP of Compliance in the legal division.”—Pilot participant

“[Company name] maintains a rigorous employee commitment and accountability system, where key staff responsible for relevant supplier relationships will have their performance evaluation linked to the ability to advance a conflict free supply chain.” —Pilot participant

Internal communications

- At least 11 companies are communicating with management on the issue
- Companies have employed internal structures and processes to facilitate communication and accountability

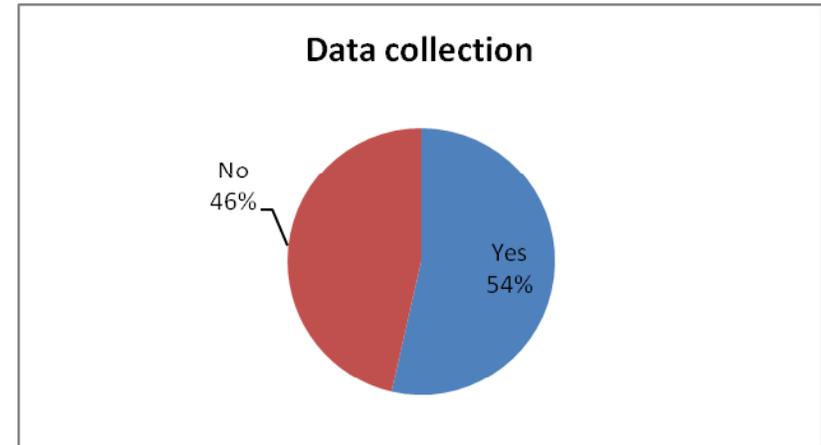
Dedicated Internal Resources



Step 1.C: Establish system of controls and transparency

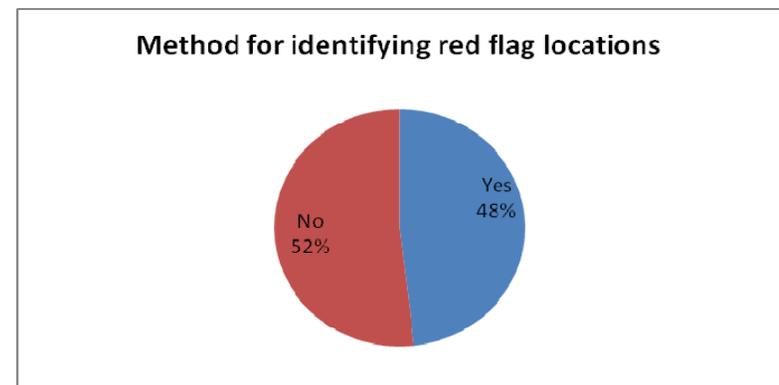
Supply chain visibility

- Majority have visibility into Tier 1
- 4 companies have visibility into Tier 2
- 1 company has visibility into Tier 3
- Visibility is gained through supplier surveys
- 15 companies have started collecting supply chain data
 - EICC-GeSI MRPRO dashboard
 - International Material data System



Identifying red flags

- Half of the respondents established methods for identifying minerals from red flag locations
- Most are using to the CFS Template to collect information
- Companies with direct relationships with smelters are able to track red flags more directly



Step 1.D: Strengthen engagement with suppliers

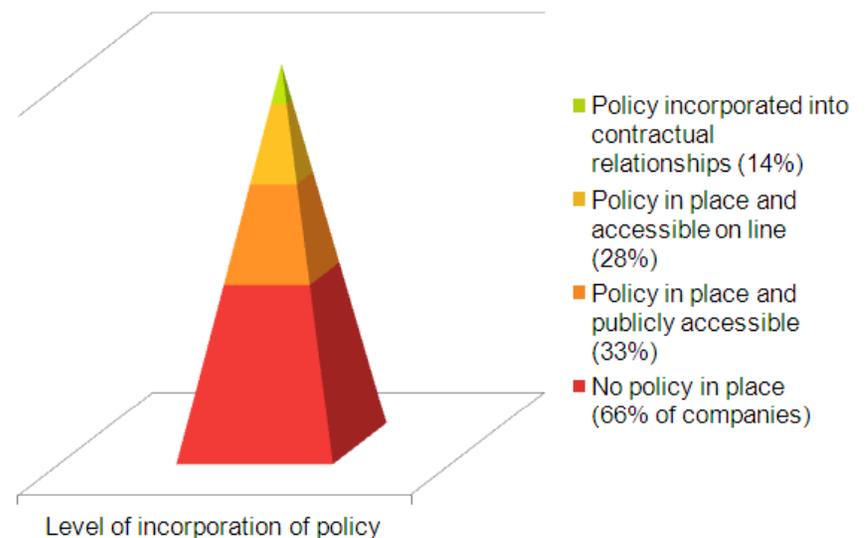
Supplier communication

- 16 companies communicate with suppliers on minerals from conflict areas
- Communicate via meetings, letters, surveys, and direct communication
 - Policy or company expectations
 - Dodd-Frank requirements
 - General background information on the issue

“We have provided our suppliers with very explanatory documents to help them understand what we are trying to accomplish. We have also tried to create letters that could easily be modified by our suppliers for use with their suppliers. These letters were provided in MS Word form to make it very easy for the suppliers to adapt the letters for their own use. We have also provided copies of all information we have received from our customers.” —Pilot participant

Contractual relationships

- 4 companies incorporate policies into their contracts



Step 1.E: Establish a grievance mechanism

Grievance mechanism

- 11 companies have a grievance mechanism in place
- Most of these companies use the same mechanism for all components of their code of conduct

“[Company] has an ombuds process for all policies and procedures, which also is available for use by suppliers and other outside entities. Once the Statement of Principles on Conflict Minerals and Implementing Procedures are in place, the ombuds process will apply to them.” —Pilot participant

Step 1: Challenges

- Understanding on how Annex II is relevant to downstream companies, which are not in the position to monitor or have reliable knowledge of armed groups' involvement
- Visibility beyond Tier 2 is challenging, with some companies nine layers away from the smelter
- Suppliers report that the quality of data received from their suppliers is limited, and there is no way to verify accuracy.
- Difficult to obtain internal buy-in, particularly for small companies that have limited knowledge of the issue

Step 1: Discussion Questions

Key questions

Why do some downstream companies find it difficult to gain visibility in their supply chain beyond the 1st and 2nd tier suppliers?

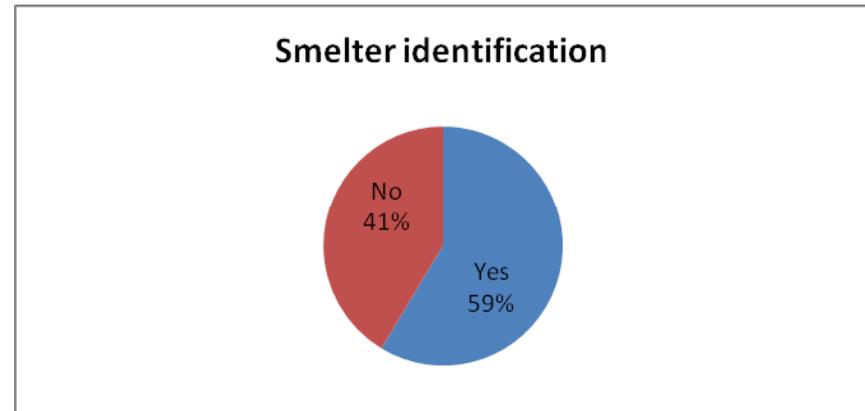
What elements in the Annex II of the Guidance are relevant to downstream companies?

Step 2: Identify and assess risk in the supply chain

Step 2.A, B: Identifying smelters and assessing risk

Smelter identification

- 17 companies started efforts to identify smelters/refiners; the majority do not have direct relationships with smelters
- Identification is partial and focused on one mineral
- Smelter information is obtained by:
 - More than half use direct communications with Tier 1 suppliers
 - 5 use the EICC-GeSI reporting template
 - 7 use contractual obligations that incorporate confidential sub-supplier disclosure requirements into supplier contracts



Risk assessment

- 11 companies obtained initial information to target risk at the smelter level
 - Supplier surveys; site visits; membership of commodity associations; market knowledge
- Companies are relying on industry programs
 - EICC CFS program; ITRI initiative

Step 2.C, D: Assessing smelter due diligence and spot checks

Smelter due diligence

- 15 companies found that identified smelters carried out due diligence
 - 12 obtained information via the CFS program because the smelter passed a CFS audit
 - 3 obtained information directly from the smelter because of direct business relationships
- Companies that are not participating in the EICC-GeSI CFS program are evaluating their participation

Spot checks

- 11 companies determined spot checks are necessary
- Most companies are relying on the CFS program and its third-party audits to carry out spot checks

“Many suppliers regard their supply chain as confidential business information or intellectual property. There is a great deal of concern (well merited in some cases) that customers will try to reverse-engineer the product supply chain.

We have tried several tactics:

- *Writing letters assuring suppliers that we are not interested in the identity of their suppliers, just the smelters and mines. They can label all levels of the supply chain between themselves and the smelter as Supplier A, Supplier B, etc.*
- *Signing Non-Disclosure Agreements (NDAs). This is difficult, as the purpose of learning the identity of the smelters and mines is to disclose it to our customers. We have only had success with this tactic in one case, but it took about 10 rounds of drafts of the NDA.*
- *Supplying the suppliers with the EICC list of smelters. If their smelters were not on the EICC list, we have asked them to identify the smelters.” —Pilot participant*

Step 2: Challenges

- Lack of direct business relationships with smelters as a challenge to identifying and assessing risk in the supply chain
- Pace of progress to verify smelters across all three mineral streams
- Identifying all of the vendors that supply products containing 3Ts, particularly for those companies that use thousands of parts in their manufacturing process
- Suppliers that own intellectual property of configuration of materials
- Resolving confidentiality issues, trade secret concerns and non-disclosure assurances
- Overcoming lack of resources among suppliers to implement due diligence requirements

Step 2: Discussion Questions

Key questions

What do downstream companies do to identify and assess risk in the supply chain?

Is it to determine what smelters they source from and compare that list to a list of smelters validated to be compliant with the OECD Guidance?

When only 3 participants in the downstream pilot have business relationships with smelters, would they share information of the main smelter names, locations, participation rate in the CFS program?

What other industry schemes or best known methods have emerged beyond CFS and the EICC-GeSI common reporting template?

Step 3: Design and implement a strategy to respond to identified risks

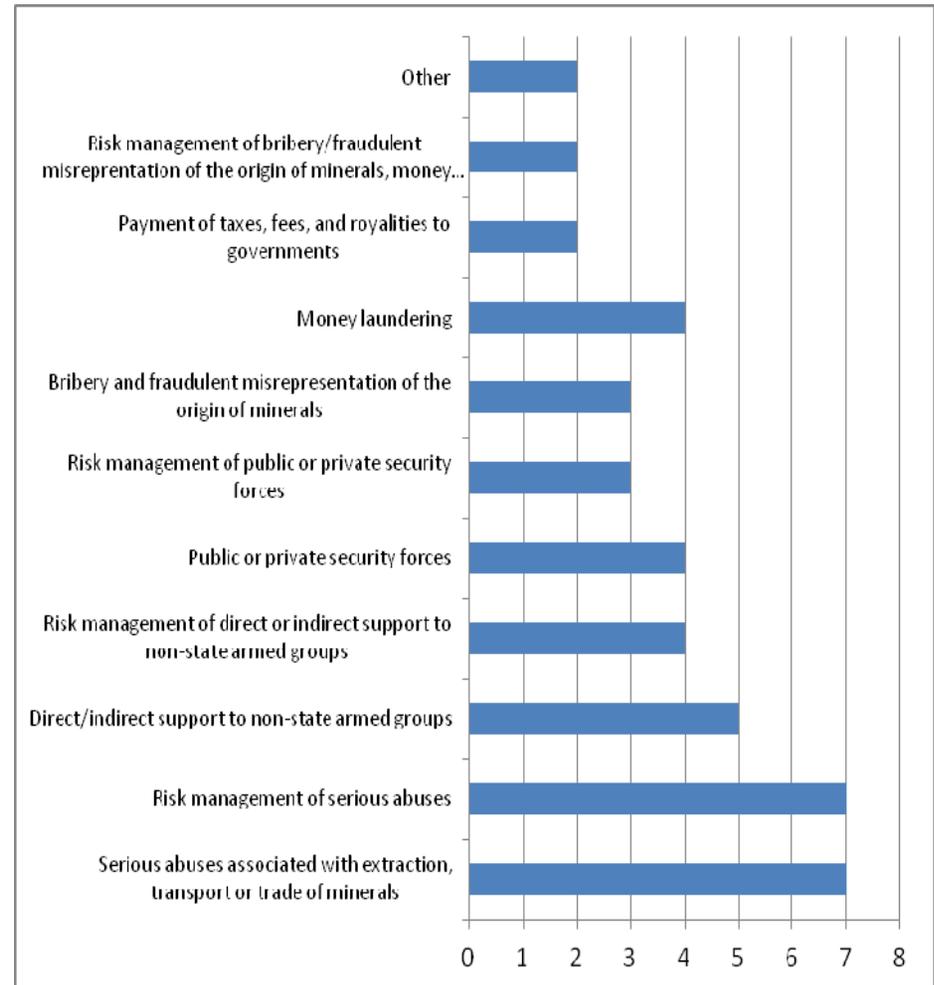
Step 3.A: Reporting findings to management

Communicating the risks

- 13 companies have formal communications processes to ensure actual and potential risks are reported to senior management
 - Report to senior steering groups on conflict minerals/corporate responsibility leadership committees
 - Regular meetings between specific functional departments (operations review with legal, procurement etc.)
 - Weekly briefings with the executive office
 - Quarterly reports

Identified risks

- Respondents cited the following abuse from the model policy in Annex II as the most commonly reported issue to senior management:
 - “Risk management of serious abuses”
 - “Serious abuses associated with extraction, transport or trade of minerals”



Step 3.B: Devise and adopt a risk management plan

Defining an approach to risk

- 2 companies use the model supply chain policy from Annex II to determine whether identified risks can be mitigate by continuing, suspending, or terminating supplier relationships
- 6 use their own, company-developed approaches to mitigating risk (policy, Sourcing Code with categories, or in conjunction with industry approaches)
- 18 companies have yet to define an approach to managing risk, a number are waiting final SEC rules; but goal is to have an approach in place within 6-18 months



Step 3: Challenges

- Practical approaches that can be implemented in complex supply chains and in a business environment
- Coordination of collaborative efforts, ideally formalized under one framework
- Companies seek further clarification on:
 - Aspects within the Guidance and Annex II that identify specific roles and responsibilities for downstream companies based on their place in the supply chain
 - Which parts of the Guidance and Annex II will be covered via in-region schemes
 - Which parts of the Guidance and Annex II could be covered by industry collaborations like the EICC-GeSI CFS program

Step 3: Discussion Questions

Key questions

What do downstream companies do to manage risks with suppliers that they have a business relationship with? Use leverage to influence them to source from smelters found to be consistent with the OECD Guidance, or something else?

*What can downstream companies do to manage risks with suppliers that they do **not** have a business relationship with?*

Which elements of the OECD Guidance and the UN GoE due diligence guidelines present the best opportunities for industry collaborative schemes, such as the EICC-GeSI CFS program?

Step 4: Third-party audit of smelters/refiners' due diligence practices

Step 4: Carry out independent third-party audits of smelters

Smelter audits

- More than half of companies in the pilot rely on the CFS program for audits
- 7 do not know whether their suppliers are being audited and do not have visibility into which smelters are engaged in CFS
- Only 1 company reported that they conduct their own audit
- Companies that have not yet planned audits intend to use the CFS program or have their suppliers who procure from smelters verify that smelters are sourcing responsibly

“At this point in time, it is not clear if smelters in our supply chain are undergoing or have completed audits. To date, there has been very limited visibility as to which smelters are engaged with the EICC and GeSI CFS programs. We are working with these organisations to gain more visibility and subsequently support the CFS program. We have every intention of leveraging this work rather than creating a separate program, given the high degree of overlap in [different industries] supply chains.”

“Currently and because this process is evolving we are concerned about verification of supplier information regarding smelter information and mine-of-origin. We plan to remedy this by implementing contractual language with our suppliers over time, and by including requirements in our supplier specifications followed by periodic supplier quality audits.” — Pilot participant

Step 4: Challenges

- Creating a tipping point for smelter participation in the CFS program, particularly for smelters outside of the U.S. and Europe; some suppliers exhibit reluctance to provide proprietary information for competitive reasons
- Managing administrative and cost burdens associated with due diligence – example customers that only accept certain auditing firms
- Complexity of obtaining information from cost-driven buyers that change suppliers frequently, sometimes daily
- Building capacity of trained auditors on content and structure of the mineral supply chain
- Limited visibility into which smelters are engaged with the CFS program

Step 4: Discussion Questions

Key question

How can the EICC-GeSI CFS program be regarded as an implementing tool to operationalise Step 4 of the Guidance?

Step 5: Report annually on supply chain due diligence

Step 5: Annual reporting on due diligence

Communicating the risks

- Less than a third of companies communicate publicly on due diligence procedures
 - 7 companies provide information through corporate social responsibility reports
 - 5 communicate activities through company website
- Most companies that are not reporting are awaiting final Dodd-Frank ruling

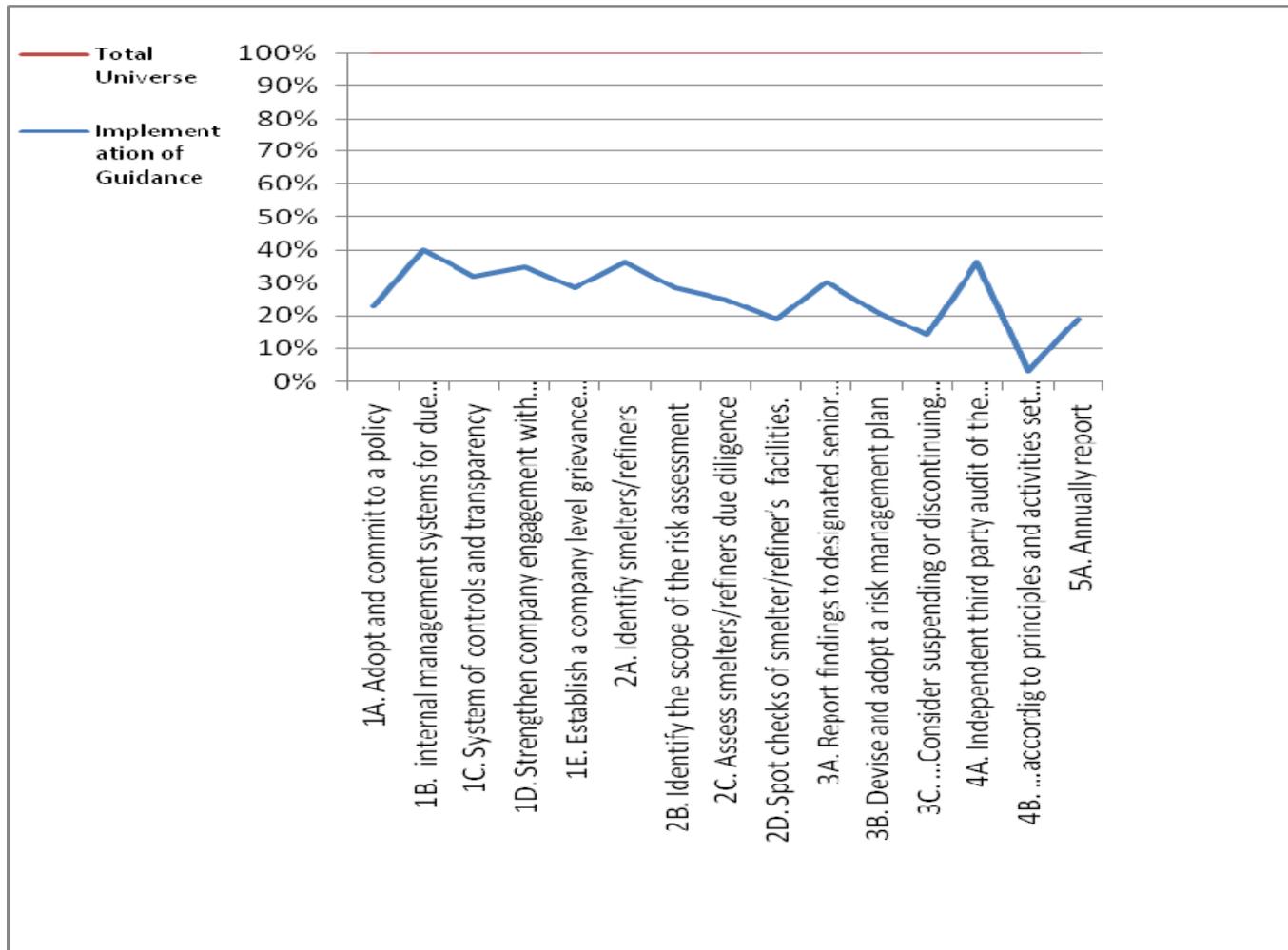
“We currently report our policy position on this issue in the Corporate Citizenship report located on our website. We will report our due diligence activities when the U.S. regulations are promulgated and clarity of the requirements is provided.” —Pilot participant

Communicating the risks

- 7 companies communicate on an annual basis
- 2 companies communicate only when “there is something to report”

Demonstrating progress

- Initial baseline



Progress and Measurement Discussion Questions

Key questions

How can due diligence progress be demonstrated and measured? (by supplier declarations of their engagement with Tier 2 suppliers? Naming smelters? Etc.)

Can the ICGLR-OECD-UN GoE forum on implementation of the OECD and UN GoE due diligence recommendations assist with the development of indicators for assessing progress and any other implementing tools?