OECD DUE DILIGENCE GUIDANCE FOR RESPONSIBLE SUPPLY CHAINS OF MINERALS FROM CONFLICT-AFFECTED AND HIGH-RISK AREAS

First meeting of the OECD-hosted working group on gold

4 May 2011

Summary Report

The meeting was conducted under Chatham House Rule: "When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed."

I. Introduction

The first meeting of the OECD-hosted working group on gold provided the opportunity for members of the working group to discuss the first draft of the Supplement on Gold. Participants in the meeting included OECD, ICGLR and other partner countries, international organisations, industry at several levels of the gold supply chain, international and local civil society organisations, expert consultancy groups and other independent experts.

The OECD Due Diligence Guidance on Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas (the “Guidance”) was finalised and approved by the OECD Investment Committee and OECD Development Assistance Committee in December 2010. The Guidance clarifies how companies can identify and better manage risks throughout the entire mineral supply chain in order to respect human rights, avoid contributing to conflict and cultivate transparent mineral supply chains and sustainable corporate engagement in the mineral sector.

This work is the first example of a collaborative government-backed multi-stakeholder initiative on responsible supply chain management of minerals from conflict-affected areas. It has been endorsed by eleven Heads of State and Governments of the International Conference on the Great Lakes Region in the Lusaka Declaration adopted on 15 December 2010. Furthermore, the UN Security Council on the DRC supported taking forward the due diligence recommendations contained in the report of the UN Group of Experts on the DRC which rely on the OECD Due Diligence Guidance.

The general recommendations contained in the five-step due diligence framework of the Guidance (Annex I) and the Model Supply Chain Policy for a responsible global supply chain of minerals from conflict-affected and high-risk areas (Annex II) already apply to gold. However, specific minerals often present unique challenges for supply chain due diligence and may be worth additional consideration. In

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the gold supply chain, such challenges include gold’s intrinsic high-value and fungible nature, the non-linear structure of its supply chain, as well as the multiple downstream uses of gold (e.g. whether the gold is used for investment purposes, jewellery or in some other industrial product). Due diligence practices may also differ depending on whether the gold comes from recycled “scrap” sources, artisanal-mines, or large-scale industrial mines.

Supplements, which are an integral part of the Guidance, are being developed to overcome the unique challenges relating to specific minerals. The Supplement on Tin, Tantalum and Tungsten is already available, and the OECD Investment Committee and Development Assistance Committee agreed to set up a multi-stakeholder OECD-hosted working group on gold to help develop a new Supplement on Gold.

The Supplement on Gold is intended to provide guidance on how companies should address the specific due diligence challenges they may face at various levels of the supply chain. As a result, the specific due diligence recommendations will be tailored to the various actors in the gold supply chain, including gold miners (small, medium or large-scale), exporters, refiners, gold traders and clearers, bullion banks, manufacturers and jewellers and other downstream users.

While it is understood that industry would not knowingly accept conflict gold, more work needs to be done to outline the steps that industry should take to avoid the risk of accepting gold associated with conflict when it finds out that it is sourcing from conflict affected and high-risk areas. The Supplement on Gold would not by any means suggest that companies should engage in conflict or high-risk areas. But, should a company decide to continue operate or source from these difficult environments, the Supplement on Gold will provide a step by step due diligence process to enable companies avoid contributing to conflict and human rights abuses through their sourcing practices. If implemented in good faith, due diligence will offer companies the opportunity to “know and show” that they are sourcing responsibly, thus considerably reducing their exposure to reputational risk.

The development of the Gold Supplement is also intended to offer opportunities for cross-fertilisation between OECD work and pioneering industry initiatives on responsible supply chain management, with a view to ensuring maximum harmonisation of standards and processes.

A first draft of the Supplement on Gold was circulated in April 2011 in advance of the first meeting of the OECD-hosted working group on gold. It is expected that a final draft of the Supplement on Gold would be finalised and submitted for consideration by the Investment Committee and the Development Assistance Committee by the end of 2011.

II. Objectives

The first meeting of the OECD-hosted working group on gold sought to discuss the challenges to carrying out due diligence for conflict-free gold supply chains, solicit concrete feedback on the first draft of the Supplement on Gold ("draft Supplement"), and agree on next steps for further revision of the draft Supplement.

The meeting was divided into five sessions. Specific objectives for each of the sessions included:

- Session I – Setting the scene
  Update participants on the relationship between the gold trade and conflict, including how gold from conflict-affected and high-risk areas is entering the supply chain; introduce and agree on the Terms of Reference for the OECD-hosted working group on gold; introduce the draft Supplement and discuss any high-level issues not covered in the specific sessions.
- **Session II – Upstream systems of controls and transparency in the gold supply chain – Step 1(C) of the draft Supplement on Gold**
  Comparatively review existing industry chain of custody tracking, traceability systems and internal controls of the upstream gold supply chain and recommend best practices or issues for consideration in the revised draft (Step 1 (C)).

- **Session III – Downstream systems of controls and transparency in the gold supply chain – Step 1(C) of the draft Supplement on Gold**
  Comparatively review existing industry internal controls of the downstream gold supply chain and recommend best practices or issues for consideration in the revised draft (Step 1 (C)).

- **Session IV – Identifying and assessing risk in the gold supply chain – Step 2 of the draft Supplement on Gold**
  Comparatively review existing industry supply chain risk assessments, including “know your customer/counterparty” measures, and recommend best practices or issues for consideration in the revised draft (Step 2).

- **Session V - Carrying out an independent third-party audit of the refiner’s due diligence – Step 4 of the draft Supplement on Gold**
  Review the independent third-party audit recommendations in the draft Supplement and discuss whether refiners are an effective choke point to target supply chain audits.

Questions were posed to the participants in the annotated agenda to inform the discussion and meet these objectives.

**III. Summary Conclusions**

Participants recognised the leading role the OECD had already taken with regard to issues of responsible sourcing of minerals through the development of the *OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas*, and welcomed the work planned for the *Supplement on Gold*. Participants noted that the first meeting of the OECD-hosted working group on gold as one of the first gatherings of such a diverse range of stakeholders convened specifically to explore due diligence on gold from conflict-affected and high-risk areas.

**Challenges in the gold supply chain and concrete feedback on the draft Supplement**

Many participants welcomed the draft Supplement as providing a good basis for supply chain due diligence on gold from conflict-affected and high-risk areas, particularly as it relates to gold from large-scale mines, and for identifying potential risks of “leakage” for recycled/scrap gold. Participants generally agreed however that more work was still necessary to address additional challenges specific to the gold supply chain, reduce any unnecessary due diligence burdens and avoid any potential harmful consequences of due diligence (see below).

Some participants felt that the draft Supplement should be more flexible and less prescriptive. *It was clarified that the OECD Due Diligence Guidance is integral to the draft Supplement, and as such, the explanatory notes on practicality and flexibility of due diligence in the Introduction to the Guidance were likewise relevant for the draft Supplement (e.g. on integrating due diligence measures into pre-existing systems, cooperating with suppliers, coordinating with other operators or other stakeholder to carry out elements of due diligence through joint efforts). It was further clarified that the Guidance expects reasonable and good faith efforts of the company to carry out due diligence (i.e. due diligence is a responsibility of process and not result), and it was not expected that companies would be able to implement all the due diligence recommendations overnight.*
Some participants explained that in order to effectively control gold from conflict-affected and high-risk areas, and eliminate it as a source of revenue for parties to the conflict, it was necessary to complement corporate due diligence recommendations with specific and targeted recommendations for governments. One participant noted the work of the Financial Action Task Force as an example, which coupled anti-money laundering recommendations for industry (e.g. financial institutions and dealers in precious metals and stones) with anti-money laundering recommendations for government (e.g. financial intelligence units). It was clarified that while the immediate purpose of the exercise was to develop guidance and recommendations applicable to companies so that they can know and show that they are sourcing conflict-free gold, OECD work on due diligence is a joint effort of the OECD Investment Committee and the Development Assistance Committee. As such, any current or planned work on implementation of the Guidance or Supplement on Gold (once complete) would look into how government could do more to enable conflict-free sourcing of gold. It was further clarified that the opportunity to develop specific recommendations for central banks will be explored during the review process.

Some participants questioned whether it was appropriate to expect companies to make such extensive efforts in their supply chain when gold from conflict-affected and high-risk areas such as eastern DRC represents such a small portion of international gold production. It was clarified that, in line with the approach taken in updated OECD Guidelines for Multinational Enterprises and by the UNSRSG John Ruggie, companies are expected to tailor their due diligence to the severity of the adverse impacts associated with their activities and relationships. Extraction and trade in gold have often been associated with severe adverse impacts such as contribution to conflict, human rights abuses and conflict financing. Although the percentage of gold associated with actual conflict as compared to the global volume of production may be considered negligible, the adverse impacts on local communities are huge. It follows that in spite of the low risk probability, the severity of the adverse impact justifies undertaking a specific type of due diligence to promote responsible sourcing practices. Another participant further noted that providing direct or indirect support to non-state armed groups in the DRC through the extraction or trade in gold was a sanctionable offense under UN Security Council resolutions.

It was also clarified that the Guidance applies to gold from any conflict-affected and high-risk area. One participant raised concerns that gold is produced through artisanal and small scale mining (“ASM”) in many areas that could be considered “high risk” (e.g. Colombia, Indonesia, Philippines), and therefore the Guidance would apply to a wider set of gold producing areas other than just the eastern DRC.

More generally, participants also noted that the risks associated with gold from conflict-affected and high-risk areas creates natural disincentives for companies acting in good faith to source gold from there, meaning the perceived risks associated with sourcing gold from any conflict-affected area, or any location where gold from conflict-affected areas is likely to transit, may be beyond what many companies (particularly companies based in OECD countries) are willing to tolerate. As a result, some participants felt that creating due diligence standards and processes that only some companies in the supply chain would observe could create parallel markets for “conflict-free gold”, “recycled/scrap gold” and “unknown/conflict gold”. Participants agreed that the working group should consider how to build incentives for responsible sourcing into the due diligence measures of the draft Supplement or create complementary incentives during any follow-up implementation work for the Supplement on Gold, once complete.

Participants agreed that one way to begin creating incentives was to raise awareness of the potential positive impacts of sourcing gold responsibly from conflict-affected and high-risk areas, so that companies willing to source from there could justify the risks and their due diligence efforts to the public, customers, regulators, investors and managers. Participants noted “fair trade” labelling as an example of how to market a positive message.
Participants identified gold from artisanal or small-scale mines as one of the more acute examples of the challenges for due diligence for conflict-free gold supply chains. On the one hand, gold from ASM sources in conflict areas presents significant risks of contributing to conflict, which are difficult and often burdensome to identify and manage because of the more complex and fragmented nature of ASM gold supply chains. As noted above, these challenges create a natural disincentive for bona fide customers to purchase ASM gold. On the other hand, due diligence measures should consider how to not adversely impact vulnerable ASM groups, and should aim to support the development of ASM communities in conflict-affected and high-risk areas, as is recognised in paragraph 9 of the model supply chain policy (Annex II) of the Guidance. One participant suggested a possible way to overcome this tension was to include text in the beginning of the Supplement clarifying that nothing in the Supplement should be interpreted to adversely impact ASM communities. Further, the updated OECD Guidelines for Multinational Enterprises, on which the OECD Due Diligence Guidance is based, clarify that, “Enterprises are encouraged to: [...] (2) Engage in or support, where appropriate, private or multi-stakeholder initiatives and social dialogue on responsible supply chain management while ensuring that these initiatives take due account of their social and economic effects on developing countries and of existing internationally recognised standards.”

The steps forward

Participants felt that some stakeholders that would be vital to the success of due diligence efforts for conflict-free gold supply chains should be invited to participate in the OECD-hosted working group on gold. Participants considered it a priority to invite key non-member countries and companies in the gold supply chain based in those countries. It was clarified that relevant non-OECD countries had been invited. An associated commodities trading group from those countries had already confirmed their participation in the working group, but due to scheduling conflicts, was unable to attend the first meeting. Participants also noted that all the relevant agencies within the participating countries, such as customs authorities, finance ministries and central banks, should participate to share their relevant expertise.

Participants agreed to set up a Drafting Committee composed of willing members of the OECD-hosted working group on gold, which would take responsibility for integrating comments from members of the working group and making any subsequent revisions to the Supplement.

IV. Summary of additional issues addressed in each session

a. Session I – Setting the scene

The participants were updated on the situation on the ground in eastern DRC and the various ways in which gold was used to finance non-state armed groups and public security forces. Participants also learned about the precarious post-conflict situation in gold producing areas of Ituri, DRC, where the artisanal miners still retained their arms from past conflicts. If these miners were unable to sell their gold because of the heightened risks involved, there would be a real risk that these artisanal miners could re-arm, reigniting conflict and instability. Therefore, it was agreed that while the risks of purchasing gold from informal artisanal miners may be high, companies should also factor the adverse impacts of disengagement into their decision-making, as recommended in the updated OECD Guidelines for Multinational Enterprises (see above).

Participants also learned about artisanal and small-scaled mining in other potentially high-risk areas. The complexity and diversity of the ASM gold supply chain was presented in some detail, and participants generally agreed that more work was needed in the draft Supplement to address these complexities. Aside from the general challenges and potential harmful consequences of the due diligence of sourcing companies on ASM communities noted above, some participants also felt that as drafted, artisanal and small-scale miners would find it very difficult to carry out the due diligence recommendations in the draft.
Supplement, due to lack of capacity and resources. It was clarified that the due diligence recommendations of the draft Supplement would apply to artisanal and small-scale enterprises, and were not addressed to informal artisanal miners or working groups. It was suggested to include a special section in the draft Supplement for ASM gold.

Participants discussed the Terms of Reference for the implementation phase. It was clarified that the OECD Secretariat would facilitate dialogue among stakeholders through periodic consultations, and in the interest of transparency, all submissions received by the Secretariat will be posted on the collaborative web portal dedicated to this project. After some minor clarifications, the Terms of Reference were adopted by participants.

After a brief introduction to the draft Gold Supplement, participants had the opportunity to discuss any other general issues which would not be covered in the individual sessions, such as the structure of the draft Supplement, the general approach taken and the definitions therein.

On the definitions of gold, one participant explained that existing gold stocks held by bullion banks included thousands of tons of gold bars that are not “London Good Delivery”. These existing stocks should be factored into the definitions provided. It was clarified that the term “accredited bullion” is used in the draft Supplement to refer to London Good Delivery bars, whereas other bullion would fall under “original recycled/scrap gold”. It was explained that this distinction was made because the assay standards for London Good Delivery were very high (and as a result London Bullion Market Association ("LBMA") accredited Good Delivery refiners were generally reputable companies subject to rigorous anti-money laundering (AML) regulations), which, in turn, may provide an opportunity to exclude London Good Delivery bars from the application of the draft Supplement.

In addition, participants noted the significant existing gold stock, on which due diligence may or may not have been conducted. Participants recognised that it would be impractical, if not impossible, to retrospectively ascertain any chain of custody data or qualitative information on the circumstances of extraction, trade and handling on such existing stocks. Although the OECD Guidance focuses on responsibilities of companies to conduct due diligence, in particular on suppliers, rather than certifying actual gold stocks, participants nonetheless agreed to consider whether and how to deal with such existing stocks, and whether they should be excluded or “grandfathered” from the application of the Supplement (“grandfathered gold”).

b. Session II – Upstream systems of controls and transparency in the gold supply chain – Step 1(C) of the draft Supplement on Gold

The draft Supplement provides specific recommendations on establishing a system of internal controls (e.g. chain of custody) and transparency in the gold supply for (i) gold producers and exporters and (ii) refiners. It also includes a detailed Appendix on chain of custody information to be collected and maintained as part of these control systems. The Guidance recommends that refiners collect and maintain different information depending on whether they are refining mined gold, original recycled/scrap gold, consolidated recycled/scrap gold, melted recycled/scrap gold and/or mixed gold. The Supplement distinguishes between these sources because of the risks of leakage into the supply chain.

Participants noted some common ground between the chain of custody recommendations in the draft Supplement and the existing efforts of the private sector and the draft chain of custody standards of the Responsible Jewellery Council. The common ground included, among others, some of the internal control recommendations (e.g. on handling material), the risk-based approach taken in the draft Supplement, a focus on management processes, recommendations for policies and grievance mechanisms, and detailed risk assessments.
Participants noted some differences between existing chain of custody best practices and the recommendations in the draft Supplement as well. One participant noted that the draft Chain of Custody standard of the Responsible Jewellery Council for example deals proactively with chain-of-custody (e.g. declaring material to be eligible from the start of the chain of custody, and then relying on each subsequent handler of the material to put in place a number of processes to maintain chain of custody), avoiding the complexity of trying to retrospectively reach back through the supply chain to find or generate provenance information. It was clarified that the draft Supplement would only expect companies to retrospectively reach back through the supply chain to find or generate information if those upstream suppliers had failed to carry out due diligence as recommended in the draft Supplement. In other cases, where upstream suppliers had carried out due diligence as recommended, the chain of custody information would automatically be provided to them.

Another issue that arose was the limits on disclosing information within the supply chain and publishing information subject to “commercial confidentiality and other competitive or security concerns”. Participants noted that defamation may also be a concern for companies disclosing or publishing information on their supply chains. Participants agreed that additional work was necessary to further define what was confidential for disclosure and publishing purposes.

Participants also recognised the need to further address the role of intermediaries, middlemen and transporters as it relates to chain of custody and due diligence in general, particularly for ASM gold. In that regard, participants explained that traders often pre-finance intermediaries to purchase gold at competitive prices from ASM sources scattered over very large geographical areas, reducing any incentive for intermediaries to conduct due diligence on those sources, and making it even more difficult to track once the gold is consolidated by the trader.

Participants also felt that the Supplement should consider specific challenges associated only with semi-industrial and large-scale mining (LSM), including security issues, their relationship with artisanal miners, and the risks of conflict gold being unknowingly introduced (particularly when purchasing gold from artisanal miners). It was suggested that the working group consider whether and how to restructure the Supplement to address LSM and ASM issues respectively.

c. Session III – Downstream systems of controls and transparency in the gold supply chain – Step 1(C) of the draft Supplement on Gold

The draft Supplement provides specific recommendations on establishing a system of internal controls and transparency in the gold supply for (i) bullion banks and (ii) all other downstream companies. It also includes a detailed Appendix on chain of custody information to be collected and maintained as part of these control systems. The Supplement recognises that some actors may not be able to identify the refiners in their supply chain, in which case it recommends they identify the bullion banks in their supply chain (if applicable) and then obtain relevant information from them. The Supplement also recognises that mined gold and recycled/scrap gold may enter the downstream supply chain directly, bypassing refiners. The Supplement recommends in such cases that those downstream companies capable of refining gold be identified and that they collect information in the same manner as refiners, where applicable.

Participants learned about the role of bullion banks and “clearers” in the gold supply chain and some of the specific challenges they face to establish chain of custody and conduct supply chain due diligence in general. For example, it was noted that there was a delay on the “maturity” of futures trading for gold, which would make it very difficult to conduct due diligence on material after trading had completed but still coming into maturity. Also, bullion banks or “clearers” may be called on to fulfil gold orders for anywhere from 1-10 tons of gold, with larger bullion bars often broken down into thousands of smaller batches for subsequent distribution. This common practice makes the identification of the refiner of the
bullion very difficult, because the original bullion bars have been broken down to smaller bars that no longer retain the refiners mark or serial number (if applicable).

Participants suggested to clearly define “refiners” in order to make recommendations regarding internal control systems such as chain of custody more straightforward.

Participants noted the role central banks could play in conflict-affected and high-risk areas to help formalise gold production and prevent smuggling, while simultaneously increasing the banks’ gold reserves (but not addressing conflict-related issues). Participants referenced the Philippines central bank in this regard, noting that members of the working group could draw lessons from their successful experience, where “(a) a result of the good price offered and a “no questions asked” policy, practically all gold produced by small-scale operations, with the exception of some small quantities principally from Mindanao, are sold to the central bank.” Participants noted however that part of the success of the Philippines in this regard had to do with the capacity of the field buying stations, and the fact that the Philippines has a LBMA Good Delivery Refiner allowing it to competitively market gold and justify the costs. It was suggested in this regard that the DRC central bank may wish to consider how to build synergies with LBMA refiners in neighbouring markets, like Rand Refinery in South Africa.

d. Session 4 – Identifying and assessing risk in the gold supply chain – Step 2 of the draft Supplement on Gold

The draft Supplement recommends that upstream companies undertake detailed, on-the-ground risk assessments on mined gold produced from conflict-affected and high-risk areas, identify potential risks of leakage for recycled/scrap gold. The draft Supplement recommends that downstream companies identify the refiners in their supply chains, or other points in the downstream supply chain where gold has been melted down and/or partially refined directly, bypassing refiners. Downstream companies should then assess the due diligence practices of those refiners and refining suppliers against the recommendations of the Supplement. Downstream companies that melt down and/or partially refine gold are an exception, and should conduct due diligence in the same manner as a refiner.

Participants learned about refiners’ and bullion banks’ existing risk-based AML “know your customer/counterparty” (“KYC”) practices. Participants recognised that as part of a risk-based approach, the complexity and burden of due diligence increases as AML risk increases. It was clarified that this approach was entirely consistent with the Guidance and draft Supplement, which rests on the assumption that certain red flags in the supply chain inhere risks of very severe adverse impacts (i.e. contributing to conflict and serious abuses) and justify additional due diligence burden.

Participants noted that as an established best practice, refiners will already make in-site, on-the-ground assessments to assess AML risks associated with mining and exporting of gold, in cases where the incentive justifies the burden. Participants therefore generally agreed that existing KYC best practices of companies, with some minor adjustments and refining, would be adequate to meet the recommendations of Step 2 of the draft Supplement, but more work would be necessary to refine the incentive/burden relationship.

Participants also suggested developing some “you may discontinue due diligence if...” pointers for the draft Supplement, since a company that doesn’t know about their supply chain is expected to conduct due diligence as recommended in the draft Supplement until they can reasonably exclude the listed red flags from their supply chain.

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e. Session 5 – Carrying out an independent third-party audit of the refiner’s due diligence – Step 4 of the draft Supplement on Gold

The draft Supplement identifies the refiner as a choke point in the supply chain and recommends audits of the refiner’s conformance to the due diligence recommendations in the Supplement. Audits of the refiners would also include an audit of a sample of their suppliers. The Supplement recognises that refiners and upstream companies already undergo a number of auditing programs, and therefore recommends that either (i) refiners integrate supply chain due diligence audits into pre-existing auditing programs; or (ii) that supply chain due diligence auditors rely on relevant conclusions (e.g. KYC audits) of pre-existing audits, so long as those audit are in accordance with the principles of ISO 19011.

Due to time limitations, participants were asked to make written submissions on the issues to be addressed in this session.

V. Next Steps

The participants in the first meeting of the OECD-hosted working group on gold agreed on the following next steps:

- Submit written comments and/or track changes on the first draft of the Supplement on Gold to the OECD Secretariat (tyler.gillard@oecd.org) by 31 July 2011.

- Set up a Drafting Committee composed of willing members of the OECD-hosted working group on gold, which would take responsibility for integrating comments from members of the working group and making any subsequent revisions to the Supplement. The drafting committee’s objective is to produce a final negotiated draft that reflects the multi-stakeholder consensus reached through discussion and compromise. The Drafting Committee will have a balanced tripartite structure reflecting the composition of the stakeholders in the working group, would be small and nimble enough to communicate regularly and easily, and be responsive to issues and discussions as they arise. During the meeting some representatives of OECD and partner countries, as well as industry and civil society organisations volunteered to join the Drafting Committee.

- Give special consideration to the following issues during the follow-up work and revision of the draft Supplement:
  
  **Artisanal and small-scale mining** (including any potential harmful consequences of due diligence, and the role of transporters, gold trading centres and pre-financing);
  **The role of central banks**;
  **Grandfathering existing gold stocks**;
  **Commercial confidentiality in the gold supply chain and transparency issues**; and
  **Recycled/scrap gold**

  In general, in each substantive area of work the Drafting Committee should consider how to create incentives for responsible sourcing.

- Reach out to other stakeholders and invite them to participate in the OECD-hosted working group on gold, in particular India and United Arab Emirates, and companies in the gold supply chain based in those countries. (As well as relevant authorities within governments – customs authorities, finance ministries and central banks).