The real cost of compliance

Proposed new voluntary measures to regulate the EU conflict mineral imports have been widely criticised. But companies risk reputational and market damage if they choose to opt out, say ***Carl Boeuf*** and ***Elise Jones***

The global mineral trading industry is estimated to be worth about €200bn and the EU is one of the world's largest markets. In March 2103, the EU proposed measures to regulate 'conflict mineral' imports. While signifying progress towards responsible sourcing of minerals, the voluntary nature of the proposals has been criticised.

Conflict minerals in the EU context are ores and concentrates containing tin, tantalum, tungsten, their ores and gold ('3TG') originating in 'conflict-affected and high-risk areas'. These minerals are transformed into metals which are eventually incorporated into a variety of high end products.

A large part of the world's mineral resources are from developing countries with unstable political situations, notably the Democratic Republic of the Congo (DRC) and the Great Lakes Region of Africa. Mineral sales potentially further the development of these regions by providing a key source of income. However, when mineral sales revenues reach local armed groups, companies at all levels indirectly play a role in funding conflict, leading to a desire to regulate this area and encourage responsible sourcing.

US and EU approaches

Responsible sourcing is already regulated in the US under section 1502 of the Dodd-Frank Act. In summary, the act places an obligation on companies that report to the US Securities and Exchange Commission, and whose products contain 3TG, to conduct inquiries to determine whether any of their minerals originated in the DRC and nine adjoining countries. If a company "knows or has reason to believe" that the minerals "may" have originated in these countries it must conduct due diligence of its supply chains and file a "conflict minerals report". One major criticism is that the approach has led to a 'de facto' embargo on the region, encouraging companies to source minerals elsewhere to avoid the costs and potential risks involved in carrying out due diligence.

Although the act only applies to US-listed companies, many EU suppliers have received due diligence requests. The EU Commission estimates that up to 200,000 EU companies are involved in affected supply chains.

In February 2014, the European Parliament passed a resolution asking the EU to legislate along the lines of the US Act. On 5 March 2014, the commission adopted a package of measures, including a proposed regulation establishing a self-certification system for responsible importers of conflict minerals. Contrary to expectations, the EU Commission opted for a voluntary scheme with accompanying incentives. In a March 2014 letter Professor John Ruggie, author of the *UN Guiding Principles on Business and Human Rights*, explained to EU Commission president Barroso, "a move to make reporting entirely optional risks leaving the most responsible companies exposed while those least attentive to their human rights responsibilities continue their current practices undeterred." However, the EU sees strength in the regulating power of the market and consumer choice.

Proposed regulation

The proposed regulation applies to importers of minerals or metals containing 3TG into the EU that opt in to the regime. It would not apply to manufacturers, sellers or importers of finished products. The commission believes that 3TG importers, smelters and refiners are best placed to identify the origins of the minerals. This could be a significant flaw since companies that create the market for conflict minerals are excluded direct responsibility.

The proposed regulation has broader geographic scope than the US Act; it regulates EU imports of 3TG from any 'conflict-affected and high-risk areas' rather than just from the DRC and neighbouring countries. However, determining whether a country is a 'conflict-affected and high-risk area' may not be straightforward. It incorporates the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas. Essentially, an EU importer wishing to self-certify as a 'responsible importer' will have to:

- declare to the relevant Member State competent authority that it complies with the applicable due diligence obligations.
- adopt a supply chain policy consistent with the OECD guidance, incorporate this into supply contracts and communicate it clearly to the public.
- adopt a risk management strategy consistent with the OECD guidance.
- submit to independent audits.

The commission aims to publish, working with the OECD, an annual global list of 'responsible smelters and refiners' based on supply chains of self-certified 'responsible importers'.

Member states will be responsible for verifying that importers are compliant with the regime. Non-compliance may result in the non-recognition of 'responsible importer' certificates and/or the removal of related smelters and refiners from the 'responsible smelters and refiners' list. Although this may not have a direct regulatory impact on the importer's business, the reputational consequences could be material, particularly if used by NGOs to 'name and shame'.

Supporting initiatives have been proposed to encourage participation in the scheme, including financial support for SMEs and a new requirement in the commission's public procurement contracts that supplied products are 'conflict-free'.

The draft regulation is currently being debated by the EU Parliment and the Council, with agreement on the final text to be reached later this year. It seems pressure groups and investors will continue to lobby for mandatory participation and tougher regulation. Without it drivers will likely be investor and consumer demand, reputational concerns and corporate responsibility commitments.

Whatever the final outcome, companies involved in minerals trading will need to balance the cost of compliance with the proposed new regime against the risk of reputational and market damage should they choose not to embrace these new challenges.

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