RJC Fact Sheet – Implementing Section 1502 on Conflict Minerals – US Dodd-Frank Act

31 August 2012

Introduction

This Fact Sheet has been prepared by the RJC to provide general information to companies in the jewellery supply chain who may be affected by the US Conflict Minerals legislation. Because of the global nature of the jewellery supply chain, companies whose product is ultimately sold to the US market are likely to be indirectly affected by the legislation, whether or not they sell directly to a US-listed company.

Background

Why has the Conflict Minerals legislation (Section 1502) been developed?
Section 1502 was enacted to address the exploitation and trade of tin, tungsten and tantalum ("the 3T's") and gold by armed groups, which is helping to finance conflict in the Democratic Republic of Congo (DRC) and contributing to an emergency humanitarian crisis.

Section 1502 is an amendment to the US Exchange Act. It requires companies to which it applies to determine whether any of the four minerals used in their products are financing or benefiting illegal armed groups in the DRC or an adjoining country.

Gold is the main focus for the jewellery supply chain and in this Fact Sheet, however tungsten and tin (sometimes used in solder) may also be present in jewellery products.

Application

Who does Section 1502 apply to?
It directly applies to a company that uses any of the four designated minerals ('conflict minerals') if:

- The company files reports with the SEC under the Exchange Act; and
- The minerals are "necessary to the functionality or production" of a product manufactured or contracted to be manufactured by the company.

For these companies (the SEC refers to them as issuers), Section 1502 brings new disclosure and in some cases additional reporting obligations to the US Securities and Exchange Commission (SEC). These requirements are laid out in an SEC rule published in August 2012.[1]

[1] http://sec.gov/rules/final/2012/34-67716.pdf

Gold in jewellery is considered to be 'necessary to the functionality of the product' because a primary purpose of jewellery is ornamentation or decoration – that is its function (p.88).[2] There is no *de minimis,* or set minimum amount of mineral that needs to be present (p.91). This means that the law applies even if there are only small amount of gold or one of the other minerals embedded in products.

Businesses that do not file reports to the SEC, and have no direct obligations under the rule, but that are in the jewellery supply chain that include gold in their products (or tungsten, or tin) are also likely to be indirectly affected, if their products reach US companies that have disclosure obligations under Section 1502. While gold mining companies or artisanal producers are not considered to be 'manufacturing' and are therefore not issuers under the rule, they are also likely to be indirectly affected through supply chain inquiries, particularly if they operate in the DRC or adjoining countries.

What is covered under 'Contract to Manufacture'?

The SEC rule does not define this term, but lays out some general principles that issuers should consider in deciding whether they 'contract to manufacture' any products containing one or more of the four minerals. The main principle to consider is the degree of influence exercised over the product's manufacturing, particularly the materials, parts, ingredients, or components to be included. The degree of influence necessary for an issuer to be considered to be contracting to manufacture a product is based on each issuer's individual facts and circumstances. However the rule notes that a company would not be deemed to have influence over the manufacturing if it merely:

- Affixes its brand, marks, logo, or label to a generic product manufactured by a third party.
- Services, maintains, or repairs a product manufactured by a third party.
- Specifies or negotiates contractual terms with a manufacturer that do not directly relate to the manufacturing of the product (p.65).

The following are examples relevant to the jewellery supply chain that are mentioned in the rule:

- Jewellery repairs, which are commonly carried out by retailers, are not considered 'contracting to manufacture' (p.60).
- Contracting to manufacture components of products is captured under the rule (p.63). This may or may not include cover jewellery findings (e.g. clasps, earwires, bails, pin stems etc.), depending on whether the findings are a 'generic product'.
- Specifications for the inclusion of gold in products is considered 'contracting to manufacture' (p.66). For example, specifying the fineness or weight or other indicators of quality of gold appears to be covered by the rule, subject to consideration of other factors.

In light of the above, jewellery retailers who are issuers will need to look at their product lines and supplier arrangements carefully. The only specific exemption discussed in the rule relating to types of jewellery or jewellery manufacture concerns repair. As noted above, while 'generic products' are not generally considered to be 'contract to manufacture', specifying the inclusion of gold does appear to be considered 'contract to manufacture'.

So deciding if, for example, a standard design gold wedding band, gold watch, or components manufactured by a third party falls under 'contract to manufacture' may depend on factors such as the nature of supplier relationships and volumes. Being a sales agent for a watch brand may not fall under 'contract to manufacture' because in many cases contractual terms do not relate directly to

[2] Page numbers here and through the Fact Sheet refer to the PDF document of the rule found at: http://sec.gov/rules/final/2012/34-67716.pdf

manufacturing of the product. However a retailer's line of jewellery, even if selected from a 'generic' supplier range, may still be considered 'contract to manufacture' because it is a specific choice from within the sheer diversity of available jewellery designs, and/or the selection causes the manufacturer to increase the volume of production of the design. Issuers will need to consider these factors on a case by case basis, and should note that their approaches to the 'contract to manufacture' issue are likely to be reviewed carefully by stakeholders.

When is the rule effective?
All issuers will file their disclosures for each calendar year – regardless of their fiscal year end. The first disclosure (and if applicable, Conflict Minerals Report) is due on May 31, 2014 covering the 2013 calendar year (p.120). They are then due annually on May 31 for each calendar year thereafter.

Issuers must provide the required conflict minerals information for the calendar year in which the manufacture of a product that contains any conflict minerals is completed, irrespective of when the product is received from a supplier or contract manufacturer (p.124).

Supply Chain Inquiries

What do issuing companies have to do?
An issuer that falls under the rule's application must conduct a 'reasonable country of origin inquiry' to determine whether any of its minerals used in that calendar year originated in the DRC or an adjoining country (the 'covered countries') or are from scrap or recycled sources. Different disclosure and reporting requirements apply depending on the determinations of this inquiry (see next section).

What is a 'Reasonable Country of Origin Inquiry' (RCOI)
A RCOI is, as its words imply, a process of tracking back through supply chains to find the origin of conflict minerals. It is consistent with the supplier engagement approach outlined in the OECD Guidance, where issuers use a range of policies, tools and methods to engage with their suppliers. While the RCOI process must be performed in good faith and be reasonably designed, the steps and outcomes are not prescribed under the SEC rule and are therefore determined by the individual issuer (p.147). The RCOI process will differ among issuers depending on their size, products, relationships with suppliers, or other factors. The rule notes that the steps necessary for a RCOI will also depend on the available infrastructure at a given time, which will likely evolve with available tracing processes. The results of a RCOI may or may not trigger additional due diligence efforts (see next section).

The rule does state that the RCOI requirement would be satisfied if an issuer seeks and obtains reasonably reliable representations indicating the facility at which its gold was processed and that the gold either did not originate in the covered countries or did come from recycled or scrap sources. These representations could come either directly from that facility (e.g. a gold refiner) or indirectly through the issuer's immediate suppliers. The issuer must have a reason to believe these representations are true given the facts and circumstances surrounding those representations (p.148). The rule notes that an issuer would have reason to believe representations were true if a processing facility (e.g. a gold refiner) received a "conflict-free" designation by a recognized industry group that requires an independent private sector audit (p.149).

In the gold supply chain, three recognised industry groups have such refiner audit programs: the Responsible Jewellery Council (RJC Chain-of-Custody Certification); the London Bullion Market

Association (LBMA Responsible Gold Guidance); and the EICC-GeSI Conflict-Free Smelter program. All three groups have aligned their programs to the OECD Due Diligence Guidance, which is recognised by the SEC as the only currently available internationally recognised due diligence framework.

What is reasonable?

Reasonableness includes a consideration of the cost of compliance, among other factors. Under the rule, gold can be deemed not to have an origin in the DRC or adjoining country if, after a reasonably designed RCOI performed in good faith, the company has no reason to believe that the origin is the DRC or a covered country, or that recycled gold is not in fact recycled if that is the representation of its origin (p.151).

The SEC rule also notes that since the focus is on reasonable design and good faith inquiry, certainty is not required. Companies are not required to receive representations from all of their suppliers, if it would not be reasonable to go to that extent. For example, if a small amount of gold origin is still unknown after the RCOI, and there are no suspicious circumstances about that gold, a company can still declare all of its gold as 'DRC conflict-free' in its disclosure (p.150). The rule gives examples of permissible statements for disclosures in these circumstances (p.157). However companies cannot ignore warning signs or other circumstances that may indicate links to conflict.

The RCOI process undertaken is publicly disclosed (unless it determines that the rule is not applicable, for example where only exempt existing stocks have been used). The SEC rule notes that this public disclosure of the RCOI will allow interested stakeholders to evaluate the degree of care taken by the issuer in the RCOI and form their own views of the reasonableness of the process. This may lead to stakeholder advocacy for different RCOI approaches, depending on available alternatives and approaches taken by other issuers (p.163-4).

What records do companies need?

Issuers don't need to maintain 'reviewable business records' and record retention requirements are not specified under the SEC rule. However the rule notes that maintenance of appropriate records may be useful in demonstrating compliance with the rule's requirements. Companies should also consider if there are specific record-keeping requirements under any nationally or internationally recognized due diligence framework applied by the issuer (p.165). The OECD Supplement on Gold recommends that supply chain and sourcing records are kept for 5 years (Step 1C).

What Suppliers to Issuers Might be Asked

Only companies that are issuers under Section 1502 are required by law to conduct 'reasonable country of origin inquiries' about the gold (and other designated minerals) in their products. However their RCOI will involve tracking conflict minerals back through their supply chains, often through multiple tiers. Suppliers of gold and gold products to these issuers (who may not themselves be issuers) will therefore be asked to provide relevant information about the source of their gold in each calendar year, starting with 2013.

Jewellery supply chains can be complex, and retailers and manufacturers often have hundreds of suppliers of products and product components, with production lines and volumes that change regularly according to customer demand and vary from mass production to bespoke pieces. However the origin of gold in all these types of products will be of interest to issuing companies, who will need to prepare public disclosures based on the information provided by their suppliers.

The kinds of questions that suppliers may be asked include:

- Can they provide a representation or warranty that gold used in the issuer's products does not come from the DRC or an adjoining country, or comes from recycled/scrap sources?
- Can they identify the refiner/s or supplier/s of the gold used?
- Are there any 'red flags' potentially associating the gold with conflict or known trading routes for conflict gold, or otherwise raising suspicion?
- Have the refiners of the gold been independently audited under a 'conflict-free' program by a recognised industry group like RJC, LBMA or EICC?

Preparing now to be able to answer these questions will assist with a smoother implementation of Section 1502's requirements. Normally suppliers should be in the position to provide a representation "to the best of my knowledge" and/or identify the next upstream supplier. Issuers who have a suspicion that supplier's representations are not reliable are required by the rule to undertake further due diligence. Under the SEC rule, the most reliable representation is to source from audited refiners, where possible.

Disclosures and Reporting by Issuers

Disclosures on Form SD (Specialized Disclosures)
The SEC has designed a new 'Form SD' for submitting disclosure of the RCOI process undertaken by an issuer (p.344-55). A Form SD disclosure is required where the RCOI determines either of the following to be true:

- The company knows that the minerals did not originate in the covered countries or are from scrap or recycled sources; or
- The company has no reason to believe that the minerals may have originated in the covered countries and may not be from scrap or recycled sources.

In these cases, the company must disclose its determination, and provide a brief description of the RCOI process it undertook and the results, on a new form (Form SD) filed with the SEC. The brief description of the process and results of the RCOI should demonstrate the basis for concluding that the company does not need to submit a Conflict Minerals Report (see next sub-section).

The company is also required to:

- Make the RCOI description publicly available on its Internet website.
- Provide the Internet address of that site in the Form SD.

Conflict Minerals Report
A Conflict Minerals Report (p.347-55) is required if the RCOI process determines both of the following to be true:

- The company knows or has reason to believe that the minerals may have originated in the covered countries; and
- The company knows or has reason to believe that the minerals may not be from scrap or recycled sources.

If a company has reason to believe the above, then it will also have to undertake 'due diligence' (see next sub-section) on the source and chain of custody of its conflict minerals and submit a Conflict Mineral Report.

The Conflict Minerals Report must describe:

- the due diligence process/es undertaken which conform to a nationally or internationally recognised due diligence framework (see next sub-section).
- its products manufactured or contracted to be manufactured that have not been found to be "DRC conflict free."

The Conflict Minerals Report is filed as an exhibit to the Form SD. The company is also required to:

- Make the Conflict Minerals Report publicly available on its Internet website.
- Provide the Internet address of that site on Form SD.

Due Diligence

Due diligence is required to be carried out if the RCOI process triggers the need for a Conflict Minerals Report. The aim of the due diligence is to determine the source and chain of custody of any conflict minerals that trigger the need for a Conflict Minerals Report (see above sub-section).

The due diligence process (or processes) must be carried out in accordance with a nationally or internationally recognised due diligence framework (p.205-7). The SEC rule endorses the OECD Guidance as fulfilling the criteria of such a framework. The OECD Guidance is not the only framework that can be used, but any alternative must be of a similar standard in terms of due process establishment. The OECD Supplement on Gold is specifically mentioned as the only currently available framework for due diligence towards recycled or scrap gold. There is currently no recognised framework for recycled or scrap tin, tungsten or tantalum.

An issuer may rely on reasonable representations from suppliers and/or smelters in satisfying its due diligence requirement, where these fit within a nationally or internationally recognized due diligence framework. Therefore the RJC, LBMA and EICC-GeSI programs, which are aligned with the OECD Guidance and Supplement on Gold, should fit this criterion. RJC has made recorded webinars introducing the OECD Guidance publicly available on its website.

Under the Exchange Act, the SEC may determine an issuer's due diligence processes to be unreliable. Any Conflict Minerals Report that relies on such unreliable due diligence process would not satisfy the Section 1502 reporting requirement (p.199).

Types of Gold Origin

Excluded stocks outside the supply chain

The SEC rule excludes any minerals that are "outside the supply chain" prior to January 31, 2013 (p.128-130). The final rule considers conflict minerals to be "outside the supply chain" only in the following instances: after any columbite-tantalite, cassiterite, and wolframite minerals have been smelted; after gold has been fully refined; or after any conflict mineral, or its derivatives, that have not been smelted or fully refined are located outside of the Covered Countries. The SEC rule on this point is designed to provide transition relief to permit market participants to move, smelt, or refine any such existing stocks of conflict minerals until January 31, 2013 without having to comply with the rule's requirements.

This approach of grandfathering existing stocks is consistent with the OECD Supplement and Gold and RJC Chain-of-Custody Standard, which includes Grandfathered Gold (prior to 1 January 2012) as a specific category of gold origin. Both OECD and RJC restrict grandfathering to refined gold in the form of ingots, bars, coins or similar, or grain/powder/sponge in sealed containers, with a date

which can be verified through inspection of physical date stamps on products and/or inventory lists ("verifiable date").

Under the SEC rule, the very large stocks of existing refined gold in banks and vaults, as well as manufacturers' inventories of refined gold, are grandfathered as outside the application of Section 1502. Therefore using only such existing stocks in manufacturing, even after January 31 2013, would mean that no disclosure or reporting to the SEC would be required. However an issuer taking this approach may still wish to consider a brief disclosure on its website to explain the lack of SEC filing. RJC recommends that issuers and relevant suppliers keep appropriate records of verifiable dates and quantities associated with any gold exempted under the rule, in accordance with the record-keeping requirements of the OECD Supplement on Gold.

Recycled and scrap gold

Recycled and scrap gold is a type of origin that can be determined under the 'reasonable country of origin inquiry'. The SEC rule defines recycled and scrap metals in accordance with the OECD Guidance (p.230):

- "Recycled metals are reclaimed end-user or post-consumer products, or scrap processed metals created during product manufacturing. Recycled metal includes excess, obsolete, defective, and scrap metal materials which contain refined or processed metals that are appropriate to recycle in the production of tin, tantalum, tungsten and/or gold. Minerals partially processed, unprocessed or a bi-product from another ore are not recycled metals."

While the SEC rule only requires due diligence towards recycled gold that an issuer has reason to believe may not come from recycled or scrap sources, retrospective due diligence efforts by issuers would be very difficult to carry out. In practice, refiners are in the best position to carry out due diligence towards recycled and scrap gold at the time of, and as part of, their sourcing practices and this is the approach recommended under the OECD Supplement on Gold.

Refiners audited under one of the RJC, LBMA or EICC-GeSI programmes, or similar, should be able to provide a reliable representation that the gold is recycled gold with the appropriate due diligence already conducted. Because of the availability of these programmes, the absence of an audit of the refiner's (or recycler's) due diligence procedures for 'recycled and scrap' origin may be considered unreliable by some issuers.

Mined gold

Under the reasonable country of origin inquiry (RCOI), gold that is not existing stocks or recycled/scrap needs to be subject to a determination of whether it originated in the DRC or an adjoining country. Knowing the actual country of origin for all gold is not necessary (p.158). In effect, the RCOI aims to determine whether or not the gold is not from the DRC or an adjoining country, either because this is known or there is no reason to believe otherwise. If this cannot be satisfactorily established, additional due diligence requirements will apply, which seek to determine that the gold did not directly or indirectly finance or benefit armed groups in the DRC region.

Mining byproduct, such as gold extracted from copper electrolytic slimes, is not classified as recyclable and is not exempt from the rule; however the rule says that for materials that are not recyclable, the standard of due diligence is the OECD Supplement on Gold (p.231-2). The Supplement defines the origin of byproduct as the refinery point where trace gold is first separated from its original mineral ore (e.g. a copper industry refinery). Therefore the RCOI should seek to determine whether or not the refinery is not located in the DRC or an adjoining country.

'Undeterminable' results
The rule allows a temporary two-year period for all issuers, and a temporary four-year period for smaller reporting issuers, for Conflict Mineral Reports to conclude that products are "DRC conflict undeterminable" (p.186). This applies when an issuer's due diligence is unable to determine that:

- the conflict minerals in its products originated in the covered countries or came from recycled or scrap sources, or
- the conflict minerals that originated in the covered countries financed or benefited armed groups.

In this case, the issuer's Conflict Minerals Report must describe:

- its products manufactured or contracted to be manufactured that are "DRC conflict undeterminable";
- the steps it has taken or will take, if any, to mitigate the risk that its conflict minerals benefit armed groups, including any steps to improve its due diligence.

Role of Audits and Certifications

Audits and certifications play important roles in implementation of Section 1502. This section explains the different types of audits and certifications that may be relevant to issuers and their suppliers.

Audits / Certifications of Refiners under Industry Programmes
The SEC rule considers the reliability of representations to be enhanced where they are supported by a "conflict-free" designation by a recognized industry group that requires an independent private sector audit of the smelter/refiner, or an individual processing facility (p.149). The OECD Supplement on Gold also notes the role of industry programmes in 'Step 4' audits of gold refiners.

RJC, LBMA and EICC-GeSI have developed audit and/or certification programs that align with the OECD Guidance; other programs or standards may also be developed/aligned. These refiner audits/certifications can provide valuable supporting information to issuers (or their suppliers) for the RCOI and/or Due Diligence processes that issuers are required to undertake under the rule.

Audits of Conflict Mineral Reports
The rule requires that Conflict Mineral Reports include an independent private sector audit of the Report. (Except in the first two/four years, where Conflict Mineral Reports that conclude that products are "DRC conflict undeterminable" do not require an independent private sector audit.)

The rule states that the audit objective is to express an opinion or conclusion as to:

- whether the design of the issuer's due diligence framework as set forth in the Conflict Minerals Report, with respect to the period covered by the report, is in conformity with, in all material respects, the criteria set forth in the nationally or internationally recognized due diligence framework used by the issuer, and
- whether the issuer's description of the due diligence measures it performed as set forth in the Conflict Minerals Report, with respect to the period covered by the report, is consistent with the due diligence process that the issuer undertook (p.285).

These report audits are a requirement in the Conflict Minerals Report and cover the aspects relating to the due diligence conducted by the issuer. They need to be conducted in accordance with generally accepted government auditing ("GAGAS") standards, including with respect to

independence of the auditor. The rule notes that an issuer's financial auditor may audit the Conflict Minerals Report, but any applicable regulation regarding non-audit services should be considered (p.214-6).

Certification of Audit of Conflict Minerals Report
Under the rule, an issuer's audit 'certification' is in the form of a statement in the Conflict Minerals Report that the issuer obtained an independent private sector audit. This means that individuals employed by the issuer are not subject to liability for the information in the Conflict Minerals Report or the audit. It also does not require an auditor to assume expert liability regarding the audit because the audit report would not be included in Securities Act filings (p.283-4).

Links

RJC Chain-of-Custody Certification: www.responsiblejewellery.com/chain-of-custody-certification/
LBMA Responsible Gold Guidance: www.lbma.org.uk
EICC-GeSI Conflict-Free Smelter Program: www.conflictfreesmelter.org
OECD Due Diligence Guidance: www.oecd.org/daf/investment/mining

SEC Fact Sheet on Section 1502: http://www.sec.gov/news/press/2012/2012-163.htm
SEC Final Rule on Section 1502: http://sec.gov/rules/final/2012/34-67716.pdf

Contact RJC: info@responsiblejewellery.com