global witness
529 14th Street NW, Suite 1085
Washington, DC 20045
Tel: (202) 621-6665
Fax: (202) 450-1347
www.globalwitness.org

October 12, 2010

The Honorable Mary L. Schapiro
Chairwoman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Comments on Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Dear Chairwoman Schapiro,

Please find attached the comments of Global Witness to Section 1502 of the Dodd-Frank Act.

Please do not hesitate to contact us if you would like further information or have any questions.

Sincerely,

Corinna Gilfillan
Head of U.S. Office
Global Witness

cc: Paula Dubberly, Esq., Deputy Director of Policy and Capital Markets
Felicia King, Esq., Chief, Office of Rulemaking
John Fieldsend, Esq., Special Counsel, Office of Rulemaking

Global Witness submission to the Securities and Exchange Commission
Section 1502 – Financial Reform Act

12 October 2010

About Global Witness

Global Witness campaigns to break the links between natural resource exploitation, human rights abuses and corruption. We have played a leading role in developing and implementing international transparency and natural resource governance mechanisms, including the Kimberley Process Certification Scheme, of which we are an accredited observer, and the Extractive Industries Transparency Initiative (EITI), of which we are a board member.

Global Witness' hard-hitting investigations have had direct and major impacts, such as the IMF withdrawal from Cambodia in 1996 over corruption in the logging industry, the imposition of timber sanctions on Charles Taylor's Liberia in 2003, and the precedent-setting arrest of timber baron Guus Kouwenhoven, in the Netherlands in 2005.

Global Witness has run a campaign on the Democratic Republic of Congo (DRC) for the past seven years, conducting research and advocacy on a broad range of issues relating to natural resources. Over the past three years we have focused on documenting the militarisation of mining in the east of the country and the central role the trade in minerals is playing in financing the conflict there.

Our campaigning on the minerals trade is directly informed by regular, in-depth field investigations in eastern DRC, involving visits to mine sites and interviews with all stakeholders involved in the trade – from artisanal miners and local traders to government mining officials and the Congolese national army.

Based on the knowledge and experience we have gained through these field investigations and through dialogue with firms all along the supply chain, Global Witness is convinced that it is possible for companies sourcing minerals from eastern DRC to exclude from their supply chains minerals that are benefiting abusive armed groups[1]. We believe that the most effective way to do this is via comprehensive due diligence.

[1] We use the term 'armed group' here to refer to both non-state armed groups and the Congolese military, consistent with the definition used in Section 1502: 'an armed group that is perpetrators of serious human rights abuses in the annual Country Reports on Human Rights Practices'.

In July we published a guide to supply chain due diligence for companies called *Do No Harm*. The recommendations in this publication draw not only on our knowledge of the conflict minerals trade, but also on work undertaken by Global Witness staff seconded to work with the OECD on developing their diligence guidance for companies sourcing minerals from conflict-affected areas, and with Special Representative of the UN Secretary-General on business and human rights John Ruggie, who is developing more wide-ranging guidance on due diligence for companies.

We have focused this submission primarily on recommendations concerning due diligence and auditing. These are adapted from Global Witness' *Do No Harm* guide for companies and are broadly consistent with those being developed by the OECD.

Background

Global demand for minerals and metals is fuelling one of the world's most vicious and intractable conflicts. Global Witness, the UN Group of Experts and others have published numerous detailed reports highlighting how rebels and government soldiers have hijacked the trade in mineral ores from eastern Democratic Republic of Congo (DRC), while subjecting the civilian population to massacres, rape, extortion, forced labour and forced recruitment of child soldiers.

The warring parties finance themselves via control of mines in the region that produce tin, tantalum and tungsten ores and gold. They also generate substantial sums through illegal 'taxation' – i.e. extortion – of the minerals trade along transportation routes.

Congo's 'conflict minerals' are traded into the global supply chain by exporters in the east of the country before being transformed into refined metals by large international processors. The number of major international processors of conflict minerals is fairly small. For example, industry sources suggest that there are around 15 major processors of tin globally and around 10 major tantalum processors. The metals these processors produce are used in a wide range of products, including consumer electronic goods such as mobile phones and computers, as well as vehicles, jewellery, medical devices and alloys.

Policymakers are increasingly looking to due diligence as the most effective way of tackling the conflict minerals trade. The main reasons why are:

- Companies can undertake due diligence immediately. Due diligence by companies is the quickest way to make an impact on a problem that policymakers recognise requires urgent action.
- A due diligence-based approach targets the harmful elements of the minerals trade but does not punish legitimate mining and mineral trading activities.
- Due diligence is a corporate concept that manufacturers understand. Responsible manufacturers already carry out due diligence to address risks of corruption and

environmental damage. The notion of supply chain due diligence to prevent minerals from funding conflict is simply an adaptation of existing good practice.
- Due diligence is a low-cost solution. While it will require companies to enlist the help of experts or build up specialist expertise, there is no need for the establishment of complex new infrastructure – physical or managerial – and there is scope for firms to share information and therefore reduce costs.

Companies covered by Section 1502 (hereafter referred to as 'regulated persons') can meet their reporting obligations by identifying the processor from which the refined metal in their products originates and then carrying out rigorous checks on that processor's supply chain controls. The regulated person should then have these 'due diligence' measures that they have taken audited by an independent auditor.

Regulated persons can identify the processors concerned by making enquiries of their immediate suppliers and – where necessary – requiring those immediate suppliers to make their own enquiries of the companies that they buy from. There are a range of factors that make this process less challenging than some industry groups have claimed. For example:

- The supply chain between processor and regulated person is often quite short. In the case of many electronics manufacturers, the number of links in the supply chain is between one and four. Many of the intermediary companies – for example component manufacturers – already recognise that they have to play a role in helping their customers carry out due diligence.
- The supply chain downstream of the processor (i.e. the trade in refined metal) typically involves recognisable corporate entities that maintain comprehensive records of their inputs and outputs.
- Key processors involved are globally recognised brands. Some, for example the major tin processing companies, stamp each ingot they produce with an insignia that denotes the specific site where it was processed. Leading processors of mineral ores from DRC and adjoining countries have acknowledged the need to cooperate with downstream customers to enable due diligence along the supply chain.
- Global Witness has had discussions with a number of manufacturers who have confirmed that they are able to identify their processors. Some manufacturers have already identified their processors and have begun to work with them to implement supply chain due diligence and auditing measures similar to those recommended here.

With regards to assessments of processors' own supply chain controls, detailed guidance on how to do this has already been published by Global Witness in our *Do No Harm* report. The OECD and the UN Group of Experts will, in the coming weeks, publish their own guidance on how to carry out such assessments. There is an emerging consensus that, while companies must take individual responsibility for controlling and reporting on their supply chains, there is scope for them to collaborate and pool information when it comes to carrying out assessments of the processors.

Recommendations relating to specific provisions in Section 1502:

Definitions

Section 1502 applies to persons who are required to file reports with the SEC and where *'conflict minerals are necessary to the functionality or production of a product manufactured by such person.'*

We support the proposed definitions for 'necessary', 'functionality', 'production' and 'manufacturer' that are outlined in The Enough Project's September 24 2010 submission to the SEC.[2] Under these definitions, the conflict minerals provision would apply to all intentional uses of conflict minerals but would not apply to a conflict mineral that is naturally occurring or where it is a naturally occurring by-product of the manufacturing process.[3] This approach is consistent with Congressional intent and with the law's aim of bringing about greater transparency on the sourcing of conflict minerals from DRC and adjoining countries.

A weaker definition of these terms will lead to significant loopholes, possibly exempting a large number of companies that use conflict minerals from the reporting requirements. This would seriously undermine the law's intent of bringing about greater transparency on the sourcing of conflict minerals to help reduce the violence and human rights abuses in DRC.

Regarding disclosure of origin

Section 1502 requires persons using columbite-tantalite, cassiterite, wolframite or gold ('conflict minerals') to disclose annually to the Commission whether the conflict minerals originated in the DRC or an adjoining country.

The rules promulgated by the Commission in support of Section 1502 should require regulated persons to conduct sufficient due diligence to enable them to determine accurately whether conflict minerals do or do not originate from the DRC or an adjoining country.

The Commission should require regulated persons to disclose the due diligence measures undertaken to determine that conflict minerals they use **do not** originate from the DRC or an adjoining country. The due diligence measures upon which this determination can be made should be defined as follows:

1. Identifying the processor that produced the refined metal used by the regulated persons

[2] See p. 5-10 of The Enough Project's comments on Section 1502 of the Dodd-Frank Act, September 24, 2010, which outline definitions of 'necessary', 'functionality', 'production', and 'manufactured'.
[3] See p. 6 of The Enough Project's comments on Section 1502 of the Dodd-Frank Act, September 24, 2010.

2. Reviewing the processor's chain of custody documentation, specifically:

- Records of mineral consignments
- License details of traders and exporters, export and import permits
- Transportation records and shipping documents
- Processor's stock records

3. When reviewing this documentation, looking out for 'red flags' indicating a risk that the conflict minerals used by the processor originate from DRC or an adjoining country:

- The stated origins of the conflict minerals are countries that have limited or no capacity to produce them.
- The processor or their suppliers have relationships or a history that links them to DRC or an adjoining country, for example if the processor or one of their suppliers is known to have sourced minerals from the region in the past.
- The minerals supplied to the processor are part-processed and declared as originating from the country where the part-processing took place, rather than the country where the minerals were mined.[4]

In undertaking the above due diligence measures, regulated persons can pool information with other companies or draw on collective, industry-led, assessments of processors. The regulated persons remain individually responsible at all times, however, for ensuring that the due diligence on which their disclosure to the SEC is based is carried out to a high standard and that the information they submit is accurate.

Regarding due diligence of the supply chain

The rules issued by the Commission should define what constitutes sufficient due diligence to enable a regulated person who has determined that conflict minerals **do** originate in DRC or an adjoining country, to fulfil their reporting requirements under Section 1502.

The Commission should define the key components of a reliable due diligence process as follows:

- Conflict minerals policy
- Supply chain risk assessment
- Remedial action
- Independent third party audit
- Public reporting

[4] An example would be the part-processing of tantalum ore into K-salt.

This five point framework has already been adopted in draft reports by the OECD[5] and the UN Security Council Group of Experts on DRC[6] as the basis for supply chain due diligence by both upstream and downstream companies sourcing conflict minerals from DRC and adjoining countries.

We suggest that the Commission adopt and elaborate this five point due diligence framework as follows:

1. Conflict minerals policy

The regulated person should publish a clear policy setting out their commitment to respect human rights and refrain from engaging in any purchases that generate revenue for or otherwise benefit armed groups or military units that carry out serious human rights abuses or other crimes. They should undertake to abide by domestic and international law and UN sanctions and to purchase only from suppliers that have policies on conflict minerals that are in line with their own.

The policy should set out how the regulated person will assess their own operations and those of their suppliers all the way up the supply chain against these standards, including setting out the measures they will undertake to fulfil their reporting obligations under Section 1502. To fulfil these reporting requirements, the regulated person will need to obtain specific information from suppliers regarding the mine of origin of the conflict minerals and the risks of their sourcing practices financing armed groups in DRC or an adjoining country. This information is most easily gathered by those companies in the supply chain handling raw ore—i.e. processors.

Where the regulated person is a downstream manufacturer who uses refined metal, their policy therefore needs to state clearly that they will only purchase metal sourced from processors that have comprehensive due diligence measures in place. Such provisions should be built into contracts with suppliers. These could take the form of a suppliers' declaration attached to contracts.[7]

A key provision that should be stated in the policy is the requirement that comprehensive due diligence by processors includes processors undertaking on the ground assessments in eastern DRC and adjoining countries.[8] The purpose of the on the ground assessment is to gather first hand information on the conditions of extraction and trade, with a particular focus on problems such as illegal taxation / extortion by armed groups, which chain of custody documentation cannot detect.[9]

---

[5] See OECD *Draft Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High Risk Areas* and *Supplement on Tin, Tantalum and Tungsten*.
[6] See *Interim report of the Group of Experts on the Democratic Republic of Congo* S/2010/252, 25 May 2010.
[7] If the regulated person does not have a direct contractual relationship with the processor, this should not constitute a barrier to undertaking due diligence. See 'Background' section above.
[8] If the regulated person is a processor or trader of raw mineral ore, then their conflict minerals policy should commit them to undertaking the comprehensive due diligence measures described below.
[9] These could be undertaken by the processor's own staff or by consultants with the relevant expertise.

Recent investigations by Global Witness in eastern DRC show that illegal taxation / extortion, rather than direct control of mining operations, is the primary means by which the armed groups are deriving financing from the mineral trade. On the ground assessments are the only way to detect this problem and to determine whether the minerals have directly or indirectly benefited armed groups. For the purposes of implementing Section 1502 effectively, due diligence processes that rely solely on chain of custody documentation have very little value.

On the ground assessments should aim to identify any instances of armed groups benefiting from the processor's sourcing practices. They should entail first hand inspections of key operational sites including mines of origin, transportation routes, trading centres and export points, as well as interviews with informants and cross checking of chain of custody data. A guide to how to carry out on the ground assessments is contained in Global Witness' *Do No Harm* report.

Sending people to eastern DRC to gather information is something that some companies claim is too difficult. However, work by the UN Group of Experts, NGOs, journalists and others has repeatedly demonstrated that it is possible to research effectively the conditions of extraction and trade in this area.

Given the changing nature of armed control and illegal taxation patterns in eastern DRC's mineral sector, these on the ground assessments should take place on a quarterly basis.

In addition to on the ground assessments, the regulated person's policy should require processors to have their due diligence measures independently audited twice a year.

2. Supply chain risk assessment

The supply chain risk assessment is the process by which the regulated person assesses their own operations and those of their suppliers against the standards set out in their conflict minerals policy, and obtains the information necessary to fulfil their reporting requirements under Section 1502.

Where the regulated person is a downstream manufacturer, the assessment should be based on a rigorous evaluation of the processor's due diligence to check that it includes the five components outlined here (including on the ground assessments in eastern DRC and adjoining countries), that it has been carried out to a high standard and to find evidence that any problems identified are being effectively addressed.

In order to verify that due diligence exercised by the processor is sufficient and information provided is accurate, persons reporting to the Commission should carry out an evaluation at the processor's facility twice a year.

This evaluation should include:

- Review of processor's contracts with upstream suppliers and policies pertaining to conflict minerals;
- Review of reports and other documentation generated by the processor's on the ground assessments;
- Review of processor's chain of custody documentation;
- Review of audits that the processor has commissioned of their due diligence;
- Interviews with senior staff responsible for due diligence and procurement;
- Spot checks at specific points along the processor's supply chain, including the mines of origin.

The evaluation of processors' due diligence and supply chain spot checks could be carried out through industry-wide verification initiatives. The regulated persons reporting to the Commission remain individually responsible for the accuracy of any assertions they make in their submissions, however.

Where the regulated person is a processor or trader of raw mineral ore, the supply chain risk assessment should be based on quarterly on the ground assessments in DRC and adjoining countries as described above.

3. Remedial action

Due diligence means not only identifying risks, but also addressing them. When the Commission defines what constitutes sufficient due diligence by a regulated person who has determined that conflict minerals in their supply chain **do** originate in DRC or an adjoining country, it should make it clear that this includes taking remedial action, not just gathering information.

In cases where the supply chain risk assessment described above detects the presence in the supply chain of conflict minerals that directly or indirectly finance or benefit armed groups in the Democratic Republic of the Congo or an adjoining country, the regulated person should disengage with the supplier concerned immediately.

4. Independent third party audit

Existing guidance from Global Witness, OECD and the UN Group of Experts calls for independent third party audits to be carried out on companies' supply chain controls as part of their due diligence. This aspect of due diligence is given special emphasis in Section 1502, with the requirement that the regulated person's report to the Commission on the measures they have taken to exercise due diligence on the source and chain of custody of conflict minerals be subject to an independent private sector audit. Recommendations on what this independent private sector audit should consist of are set out in a separate section below.

5. Public reporting

Public reporting is another of the five elements of supply chain due diligence advocated by Global Witness, OECD and the UN Group of Experts which is given particular attention in Section 1502, in the paragraph 'Information available to the public'. The Commission should clarify that this public disclosure should include all the details that the regulated person submits to the Commission, rather than a summary.

Regarding independent audits

Section 1502 requires that regulated persons commission an independent private sector audit of the report that the person submits to the Commission. The intent behind this provision is to ensure independent verification that the information provided by the regulated person is accurate and sufficient to fulfil the requirements of the legislation.

In order to verify whether the measures undertaken by the regulated person are sufficient to reliably determine the source of the conflict minerals, their chain of custody, processing facilities and any financing to armed groups, the auditor will need to assess and report on all aspects of the regulated person's due diligence. Specifically:

- The audit should encompass a review of all relevant documentation generated by the regulated person's due diligence process as well as spot checks on their supply chain.
- The auditor should meet the professional criteria of Chapter 7 of ISO 19011 on Competence and Evaluation of Auditors and should have the specialist knowledge and skills necessary to carry out supply chain due diligence audits effectively. Expertise in financial auditing alone will not be sufficient.
- The auditor should be entirely independent from the regulated person and their suppliers, and should not have undertaken a previous audit of the person or their suppliers for a period of 24 months.

Regarding unreliable determination

Section 1502 mandates the Commission to determine the reliability of the regulated person's due diligence measures and independent audit. The Commission should issue rules that indicate clearly the circumstances in which a person's submissions to the Commission are unreliable.

These circumstances should be defined as follows:

- If the person does not disclose the measures undertaken to determine that conflict minerals they use do not originate from the DRC or an adjoining country, as defined in the section 'Regarding disclosure of origin' above.

- If the regulated person does not disclose as part of their report to the Commission full details of the due diligence measures and the independent audit.
- If the due diligence measures are not undertaken in accordance with the rules set out by the Commission, as defined in the section ‘Regarding due diligence of the supply chain’.
- If the independent audit is not undertaken in accordance with the rules set out by the Commission, as defined in the section ‘Regarding independent audits’ above.