ROPES & GRAY ALERT

Conflict Minerals and Supply Chain Compliance

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Musings on Conflict Minerals Compliance – The Year That Was, the Year That May Be and What You Should Be Doing Now

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With New Year's behind us and roughly four and a half months to go until the calendar 2015 conflict minerals filings are due, many companies are ramping up their compliance efforts in earnest. In many respects, the drill has been and continues to be the same as for calendar 2014: determine in-scope products and suppliers, conduct supplier outreach, review supplier data and report. However, in other respects, there are notable differences between the two compliance cycles, including increased scrutiny by commercial customers and NGOs and more preparation and nervousness around the independent private sector audit requirement under the Conflict Minerals Rule. In addition, the last year has seen new supply chain compliance requirements, and EU regulation of conflict minerals is drawing closer.

This Alert offers observations on the calendar 2014 and 2015 compliance cycles, predictions for the coming year and suggested action items for calendar 2015 and 2016 compliance.

The Year That Was – Calendar 2014 Compliance

As a bridge to calendar 2015 compliance and reporting, it is helpful to have some perspective on how calendar 2014 shaped up.

The Number of Filings Stayed Consistent

The calendar 2014 Conflict Minerals Rule filings were due on June 1, 2015. The number of filings for calendar 2014 was comparable to the prior year (the first year of reporting), with 1271 Form SD filings for calendar 2014 vs. 1315 for calendar 2013. In addition to the usual significant corporate events, such as IPOs and M&A activity, which result in changes to the registrant population each year, some of the reduction in the calendar 2014 filer population was attributable to the SEC's informal chemical compounds guidance.

There was some speculation that there would be a big uptick in filers this past June, since the SEC's economic analysis estimated that almost 6,000 registrants might be required to make filings under the Conflict Minerals Rule. This of course did not occur and we remain skeptical that, other than perhaps a few smaller registrants around the margins, there is willful non-compliance or ignorance of the filing requirements under the Conflict Minerals Rule. Accordingly, we expect the filer population to remain roughly the same for calendar 2015.

Few Registrants Obtained IPSAs

For calendar 2013, there were four independent private sector audits (IPSAs). Under the Conflict Minerals Rule, there are two alternative audit approaches: an attestation engagement or a performance audit. Two calendar 2013 audits were conducted under each approach, and the audits were split among four firms, with one audit each.

For calendar 2014, there were six audits. One additional firm notched its first audit (on the performance audit side). The other new audit client used a Big 4 auditing firm (an attestation engagement) that conducted an audit for another registrant in both calendar 2013 and 2014.

The Breakdown Between SD-only and SD/CMR Filers Was Consistent Year Over Year

The third area of similarity between the two compliance periods was the percentage of filers that filed only a Form SD and those that filed both a Form SD and a Conflict Minerals Report (CMR) exhibit. For calendar 2013,

approximately 23% of the filers filed only a Form SD, with the remainder also filing a CMR. For calendar 2014, 20% of filers filed only a Form SD, with the remaining 80% filing both a Form SD and a CMR.

Both the Quality and Quantity of Disclosure Increased for Calendar 2014

Although the metrics discussed above were consistent year over year, compliance and disclosure evolved from one period to the next.

For calendar 2014, registrants for the most part did a good job in meeting the requirements of the Conflict Minerals Rule, arguably on the whole better than for calendar 2013. The independent study of the calendar 2014 filings released in August 2015 by Dr. Chris Bayer, a leading researcher in this subject area, showed high rates of compliance across most of the compliance metrics that he and his team of researchers analyzed. These conclusions were consistent with our experience and filing review as well. (Note that Dr. Bayer's study often is colloquially referred to as the "Tulane study," due to his association with the Payson Center for International Development at Tulane University.)

In addition, for calendar 2014, more filings went beyond the literal requirements of the Conflict Minerals Rule than for the prior year. Because calendar 2013 was the first year of reporting under the Conflict Minerals Rule, many registrants were concerned about getting ahead of the market and took a minimalist approach in their disclosure for that year. This past year, there was more of a focus on telling a compliance story and receiving credit for all of the work done, with fewer registrants treating their report as a mechanical compliance obligation more akin to an environmental health and safety filing. Said a different way, more registrants took the same approach that they take with other narrative SEC filings, writing the disclosure not just to comply with the form requirements, but also for the key external constituencies that read the disclosure.

Some of the more significant calendar 2014 disclosure and compliance trends included the following:

Increased smelter and refiner disclosure. CMRs contained more smelter and refiner disclosure. More registrants reported smelter and refiner information than for the prior year and there was an increase in the amount of smelter and refiner information reported. A greater percentage of registrants also provided country of origin information for calendar 2014. These disclosure trends were due to increased supply chain transparency and traceability improvements.

Better organization. On balance, the calendar 2014 CMRs were better organized. There was more compartmentalization of disclosure, which improved readability. For example, more registrants included stand-alone Reasonable Country of Origin Inquiry (RCOI) sections in their CMRs. Discussions of the OECD Guidance framework also were more methodical. More registrants aligned the applicable portions of their CMR narrative to follow the five steps of the OECD Guidance framework, whether explicitly or implicitly.

More discussion of the OECD Guidance framework. The calendar 2014 filings also contained more discussion of individual elements of the OECD Guidance framework. Registrants not only discussed more elements of the framework, but in many cases also included more detail on the elements discussed. This was in part because, for calendar 2014, registrants were further along in implementing their compliance programs generally and their OECD Guidance frameworks in particular.

A larger percentage of registrants had put in place the management systems contemplated by the OECD Guidance framework (OECD Guidance Step 1), as evidenced by their disclosure. For example, many more registrants discussed grievance mechanisms and OECD Guidance-compliant document retention policies in their calendar 2014 filings. For calendar 2014, a higher percentage of filers also discussed in their CMRs the use of contractual terms and conditions.

Many registrants also described in their CMRs more robust procedures for reviewing smelter and refiner data received from suppliers. For example, many more filings discussed follow-up with suppliers that provided inaccurate or incomplete responses or responses that otherwise raised red flags. More filings also indicated that smelter and

refiner information provided by suppliers was reviewed against third-party lists of certified and known smelters and refiners. In addition, more filings indicated that internal research was conducted on identified smelters and refiners that were not certified as conflict-free, as well as outreach to these smelters and refiners.

Greater participation in multi-stakeholder initiatives. In particular, more registrants indicated that they were Conflict-Free Sourcing Initiative (CFSI) members. This was not surprising given the significant number of additional registrants that joined the CFSI over the last filing cycle. There also was more discussion in CMRs of active involvement in multi-stakeholder initiatives, such as in smelter outreach.

Inclusion of other statistics. More registrants reported the number of in-scope suppliers and supplier response rates for calendar 2014 than for the prior year. However, a minority of registrants reported these statistics.

Registrants Continued to Experience Difficulty Obtaining Quality Information from Suppliers

As noted above, many registrants received more smelter and refiner information from suppliers. However, as was clear from the filings (and consistent with our client experience), obtaining information from suppliers continued to be a challenge. As noted in Dr. Bayer's calendar 2014 filing study, the average reported nominal response rate was 81%, although the reported response rates went as low as 13%.

The Year That May Be – Predictions and Expected Compliance Trends

As discussed below, conflict minerals compliance will remain dynamic and continue to evolve over the next year, for both the calendar 2015 and 2016 compliance cycles.

A Mandatory IPSA for Calendar 2015 Remains Unlikely

In its April 2014 decision in the Conflict Minerals Rule litigation, the Court of Appeals for the D.C. Circuit concluded that the requirement to describe products as having "not been found to be DRC conflict free" is compelled speech that violates the First Amendment. In furtherance of the court's decision, the SEC stayed the mandatory IPSA requirement contained in the Conflict Minerals Rule. In the April 2014 Statement put out by the SEC following the court's decision, the SEC indicated that, pending further action, an IPSA will not be required unless a registrant voluntarily elects to describe a product as "DRC conflict free" in its CMR.

The SEC has indicated verbally that the 2014 Statement continues in effect. The audit stay is likely to remain in effect at least until the litigation is closer to resolution, and more likely until the litigation has run its course. In any case, the SEC also has informally acknowledged that registrants would need advance notice of a change in existing staff guidance, reinforcing the likelihood that the IPSA requirement will not be reinstated for calendar 2015.

Although the Court Case Continues, the Conflict Minerals Rule Is Likely Here to Stay

During August 2015, in a split decision, the three-judge panel of the Court of Appeals for the D.C. Circuit reaffirmed its April 2014 decision.

This past November, the court denied the petitions of the SEC and Amnesty International seeking rehearing en banc of the court's August 2015 decision. Many observers of the case were surprised by both the speed with which the court ruled on the petitions, which were filed in early October, as well as the court's decision.

The litigation continues, at least for the time being. The SEC has until early February to file a petition for a *writ of certiorari* seeking U.S. Supreme Court review of the appellate court's decision. Even if the SEC does not seek Supreme Court review, the case has been remanded to the D.C. District Court for further proceedings in accordance with the appellate court's decision.

There has been speculation that, at the district court level, the National Association of Manufacturers (which, together with other business organizations, brought the lawsuit challenging the Conflict Minerals Rule) will argue that the Conflict Minerals Rule should be stayed in its entirety pending a rewrite of the rule that conforms to the

appellate court's decision. Although this outcome is possible, the consensus seems to be that it is a long shot. But, then again, the First Amendment challenge to the Conflict Minerals Rule was also viewed as a long shot.

The Conflict Minerals Rule litigation could extend well beyond the May 31, 2016 filing deadline of the next Form SD. In the meantime, the status quo that has existed since April 2014 continues and is likely to be maintained for at least the current compliance period.

Rankings and Other Surveys Analyzing Filings Will Continue to Be Published

Two NGO reports were published in the lead-up to the last filing. In April 2015, Global Witness and Amnesty International published a report in which they analyzed the calendar 2013 filings of 100 registrants. They looked at 12 different compliance criteria, some of which tracked the requirements of the Conflict Minerals Rule, and some of which went beyond the requirements of the rule. In their report, Global Witness and Amnesty International concluded that, based on their compliance criteria, 79 of the 100 registrants "analyzed did not meet the minimum requirements of the U.S. conflict minerals legislation."

In May 2015, the Responsible Sourcing Network (RSN) and Sustainalytics published a report in which they analyzed 51 of the calendar 2013 filings representing 17 industry categories. The analysis consisted of 18 principal criteria. The report contained a score for each ranked industry category and the individual scores of highly ranked registrants, as well as a discussion of performance trends, leading practices and areas for improvement.

In September 2015, RSN published a second report on the calendar 2014 filings. The pool of reviewed companies was significantly larger, totaling 155 registrants. The review included more registrants in each industry category (seven to eight per industry category as compared to three in the calendar 2013 report) as well as some additional industry categories. The review criteria also were revised and expanded and included a review of both the calendar 2014 filings and the registrants' conflict minerals policies. Finally, in a significant departure from the calendar 2013 report, the individual scores of all of the surveyed registrants were published, registrants were ranked within their industry category and each was given an overall qualitative performance rating from "Superior" (90+ points out of 100) to "Weak" (less than 40 points).

During August 2015, Dr. Chris Bayer and his research team published their independent review of the calendar 2014 filings, which was sponsored by Assent Compliance. Unlike the other analyses, Dr. Bayer and his team reviewed all of the filings, not just a subset. Registrants received both a "compliance" score and a "good practices" score with 100 points ascribed to each set of indicators. The 14 compliance indicators were intended to track the requirements of the Conflict Minerals Rule (although, in some respects, the indicators went beyond the requirements of the rule), and the 18 good practices indicators were based on RSN's calendar year 2013 review criteria.

Both RSN and Dr. Bayer are expected to issue reports on the calendar 2015 filings. Review criteria will continue to evolve. New criteria will be added to take into account emerging leading practices and areas where NGOs wish to drive performance. In addition, the weighting of individual criteria will continue to evolve, with some existing criteria being allocated fewer points as compliance with those criteria becomes commonplace.

Some of the areas that are expected to receive greater attention for calendar 2015 include (1) the level of detail around the procedures for reviewing supplier data, risk mitigation and the steps to be taken to improve due diligence, (2) efforts to increase transparency, promote supplier compliance and build leverage over suppliers, (3) the level of commitment to conflict-free sourcing, (4) efforts taken to promote a responsible DRC conflict minerals trade through multi-stakeholder participation and (5) anti-embargo measures.

Direct Engagement by NGOs and Socially Responsible Investors Will Start to Increase

The NGO and socially responsible investor (SRI) communities continue to be critical of the conflict minerals compliance efforts of many registrants.

With two years of filings, some clear leaders and laggards have begun to emerge, and some of these performance disparities are likely to persist and perhaps widen for calendar 2015. We would not be surprised to start to see more direct engagement by NGOs and SRIs over the next year aimed at driving improvements in supply chain transparency and accountability, including possibly a small number of shareholder proposals.

Corporate social responsibility (CSR) proposals rarely receive enough shareholder support to pass. However, that is beside the point, since the intent of these proposals typically is to focus board and senior management level attention on an issue and encourage voluntary compliance. From that standpoint, these proposals often are successful.

As has been the case with other CSR initiatives, engagement by NGOs and SRIs is likely to occur gradually, with larger companies and household names likely to be the primary focus, at least initially.

Risk Mitigation Will Become a Bigger Focus

As RSN succinctly stated in its calendar 2014 report: "Responding to risk is the ultimate form of due diligence; simply knowing that the risk is there is only half of the equation." Although NGOs give credit for smelter and refiner and country of origin disclosure, this information is viewed by that community as but one step in the due diligence process, rather than the end goal of the Conflict Minerals Rule.

Based on conversations with clients and others, over the next year, we expect many registrants to enhance their risk mitigation policies and procedures. For many registrants, this is the last significant element of the OECD Guidance framework that remains to be implemented.

The Pressure on Suppliers Will Continue to Increase

Each year since the adoption of the Conflict Minerals Rule, registrants' expectations with respect to the quality of survey responses (accuracy and plausibility), traceability (completeness) and suppliers' conflict minerals compliance procedures (the A-J questions in the Conflict Minerals Reporting Template) have increased.

In addition, as part of the focus by registrants on mitigating risk, scrutiny of suppliers' conflict minerals policies and compliance procedures is increasing, including through both stand-alone conflict minerals compliance audits and as part of broader-based compliance audits. Following these reviews, larger commercial customers are with greater frequency requesting enhancements to suppliers' compliance programs and other corrective action.

An increasing number of registrants also are requesting product level disclosures from their suppliers.

These trends are expected to continue for the remainder of calendar 2015 and 2016.

Other Aspects of Conflict Minerals Compliance and Disclosure Also Will Be Dynamic

Compliance program enhancements will not be limited to risk mitigation and increased supplier engagement.

Many registrants continue to build out and refine other aspects of their compliance programs to conform to the OECD Guidance framework, enhance program efficiency, keep pace with peers, address changed circumstances and/or meet the requirements of commercial customers.

This year, substantially more registrants also will take into account the published feedback on past filings. Because the NGO reports on the calendar 2013 filings were published shortly before the calendar 2014 filings were due, few companies had time to take that guidance into account for their calendar 2014 compliance or reporting.

In addition, for calendar 2015, many registrants will continue to tighten up their disclosure and move toward an auditable disclosure format.

A Final EU Conflict Minerals Regulation May Be Adopted, but There Will be Time to Gear up for Compliance

During 2014, the EU Commission proposed a voluntary self-certification system focused on the approximately 400 direct importers of 3TG into the European Union. However, the EU Parliament felt that the proposed voluntary

scheme did not go far enough and ultimately voted in May 2015 in favor of a regime that would create mandatory compliance obligations for EU smelters and refiners, importers and downstream companies that use 3TG in their products.

Under the EU's co-decision procedure, the Parliament and the European Council must agree on the final regulation. Discussions toward a final regulation are expected to pick up steam in 2016.

Many commentators expect the final regulation to reflect a compromise, somewhere in between what the Commission proposed and the Parliament adopted, although it is premature to speculate as to the content of the final regulation.

However, to the extent the final regulation is mandatory, it is expected to continue to include a two-year transition period before it takes effect.

We will of course continue to keep our clients and friends up to date on EU conflict minerals developments.

What You Should Be Doing Now – Practical Compliance Tips for Calendar 2015 and 2016

In light of the expected trends in conflict minerals compliance discussed in this Alert, registrants should consider the following action items. Depending upon the registrant, its compliance program and its supply chain, some of these items are actionable for the calendar 2015 compliance effort currently underway, while other items will make more sense to defer to calendar 2016 compliance, although calendar 2016 items can be discussed as planned program enhancements in the calendar 2015 filing. And of course some of these items may not apply, depending upon a registrant's compliance initiatives to date.

Assess Effectiveness of Supplier Communications

As earlier noted, registrants' expectations of their suppliers are increasing. However, there often is a disconnect between what registrants expect and what they communicate to suppliers. In our experience, registrants that effectively communicate supplier expectations often receive higher quality survey responses and greater alignment with the registrant's compliance expectations.

The initial communication for the compliance period, and, for new suppliers, at the inception of the relationship, should be tailored to and clearly articulate the registrant's compliance expectations. In addition, to improve supplier compliance, consider conducting training and/or individual or small group outreach to selected suppliers, whether annually or on an ad hoc basis. On the back end, after survey responses are received, follow-up should be tailored to any identified deficiencies in the supplier's responses and/or compliance program.

There is no single right approach to effectively communicating compliance requirements, given differences in suppliers, whether due to spend, supplier size, sophistication, industry or geography. The message should therefore also be tailored to the particular supplier subset and its risk profile.

Finally, keep in mind that improvements in supplier performance around compliance issues are not necessarily linear, since supplier personnel tasked with conflict minerals and other areas of compliance often change from year to year and even during the compliance period. Therefore, the communications strategy and its effectiveness should be periodically reassessed.

Complete Documentation of the OECD Guidance Framework

Given the stay of the IPSA, most registrants have only partially documented their OECD Guidance framework. Documenting the compliance framework generally is a time-consuming exercise, but is significantly less painful, and more efficient, when the work can be spread out over time. The audit stay affords registrants with this luxury. Therefore, if not already done, as a calendar 2016 action item, complete the documentation of the compliance framework. This may take the form of a standard operating procedure, framework document, program manual or similar documentation.

The compliance framework should be documented in sufficient detail to satisfy the first objective of the IPSA under the Conflict Minerals Rule. Under this audit objective, the auditor is required to assess whether the design of the registrant's due diligence measures conforms in all material respects to a nationally or internationally recognized due diligence framework.

Even absent an audit, there are benefits to documenting the compliance framework. First, doing so requires a critical look at the compliance program, which often results in modifications and enhancements that increase efficiency and/or program performance. Second, putting the program down on paper helps to identify gaps in program design that could affect the ability to pass an audit. Finally, especially at larger companies, it is common practice to periodically rotate managers into new jobs, and some companies intend to, over time, migrate program management to a different department. A sufficiently documented program will be critical to a smooth transition of program responsibility.

Revisit Older Policy Statements

Registrants that adopted conflict minerals policies a couple of years ago or more should revisit those policies. Many older policy statements are out of synch with current expectations of suppliers and internal compliance procedures. Older policies also are often less robust than more recent policies of peers and competitors. In addition, in many cases, they do not reflect NGO expectations.

Review Older Contractual Terms and Conditions

Similarly, many older standard terms and conditions, supplier manual provisions and flow-down clauses relating to conflict minerals are no longer aligned with evolving registrant compliance practices, policies and expectations of suppliers. Consider whether these provisions should be revised for prospective use.

Build-Out Risk Mitigation Strategy and Procedures

As noted earlier, registrants' measures to mitigate 3TG supply chain risk are receiving greater scrutiny from NGOs and are expected to be given more weight in rankings. Larger commercial customers also are becoming more focused on their suppliers' efforts to mitigate 3TG sourcing risk.

With two, and soon three, years of supplier data, many registrants now have at least some sense of where their 3TG sourcing risk lies and are in a position to start developing a thoughtful risk mitigation strategy and corrective action plan, as contemplated by Step 3 of the OECD Guidance framework. Registrants should consider what measures may be appropriate to address risk at each of the direct supplier and smelter and refiner levels. As with many other areas of supply chain compliance, the risk mitigation strategy needs to be tailored to the perceived risk and the particular market participant and is likely to involve a multi-pronged approach.

Continue to Refine Disclosure

At a minimum, calendar 2015 disclosure will need to be updated from last year's disclosure to reflect the current compliance year's survey results and any program enhancements.

Also consider whether there are discrete elements of the compliance program that should be discussed in additional detail in the calendar 2015 filing. As competitor and peer disclosure has grown more robust and NGOs and others have ranked registrants based on their disclosure, many registrants that have taken a "less is more" approach to their disclosure are revisiting that strategy to ensure that they receive credit for all of the hard work that they are putting into complying with the Conflict Minerals Rule and responsible 3TG sourcing.

As part of assessing potential disclosure enhancements, calendar 2014 disclosure should be benchmarked against NGO and other surveys and competitor and peer disclosure, as those groups have been defined by both the registrant and the NGO community. Surveys came out too late for most registrants to address the survey findings in their calendar 2014 filings. For calendar 2015, many registrants are expected to enhance their disclosure to at least address the low-hanging fruit for which NGOs are giving credit. When benchmarking against last year's competitor and peer

disclosures, keep in mind that, in many cases, their disclosure will continue to evolve for calendar 2015, in some cases significantly.

Consider Participating in Multi-Stakeholder Initiatives

NGOs recognize that individual companies are limited in their ability to drive responsible sourcing several or more levels up the supply chain and therefore encourage participation in multi-stakeholder initiatives.

Underscoring the importance that NGOs place on these activities, participation in multi-stakeholder initiatives was factored into RSN's, and by extension, Dr. Bayer's, scoring criteria. Most larger and/or highly ranked companies participate in at least one multi-stakeholder initiative.

At a minimum, consider joining the Conflict-Free Sourcing Initiative (CFSI) if not already a member. Among other things, CFSI membership will aid in the RCOI analysis by providing access to country of origin information for certified smelters. If a larger registrant, also consider whether to participate in other multi-stakeholder initiatives.

Review NGO "Good Practices" Expectations

NGOs view compliance with the law as the floor, not the ceiling. From their perspective, it is not enough to just be familiar with and compliant with regulatory requirements. No registrant is likely to implement all of the practices advocated by NGOs. However, registrants should be familiar with the NGO "ask" so that they can take a considered approach in their disclosure and compliance procedures.

As part of this exercise, registrants should familiarize themselves with emerging NGO concerns, not only issues that have been of historical importance to the NGO community. Without continued enhancements to compliance programs and disclosure to reflect emerging areas of NGO focus, a registrant's survey scores are likely to go down year over year.

Continue Moving Toward Audit Readiness

Notwithstanding the appellate court's decision and the continuing stay of the mandatory IPSA requirement, given the potential for an audit, registrants should continue to prepare for one, albeit at a measured pace.

As discussed earlier, most registrants still have significant work to do fleshing out and tightening up their program design documentation to support the first audit objective under the Conflict Minerals Rule. This should be job one in preparing for an audit.

With more than four months until the next filing is due, most registrants are not yet spending much time thinking about their calendar 2015 filing. However, with a view to continuing to move disclosure toward an auditable format and testing the completeness of documentation and the effectiveness of related procedures, there is benefit to giving some thought now to the description of the due diligence measures performed for calendar 2015 that will be included in the CMR, which are the subject of the second IPSA objective. There is flexibility in the description. The art to this disclosure for many registrants will be including enough detail to demonstrate a credible due diligence process and address at least some NGO concerns (and in some cases customer expectations), while at the same time managing audit scope and cost if and when an IPSA is required.

In addition, in the upcoming filing, registrants should continue moving other CMR disclosure toward an audit-ready format. If not done last year, plan on compartmentalizing the CMR so that the portions that would come within the scope of an IPSA are separate from other disclosures, such as the discussion of the RCOI, in-scope product categories, smelter and refiner information and planned activities to further mitigate risk. Even in the absence of an audit, this somewhat mechanical exercise will better align disclosure with emerging market practice and NGO expectations. Compartmentalization of CMR disclosure was fairly widespread for calendar 2014, although not universal, and was much more common than for the prior year. However, even for those registrants that compartmentalized disclosure for calendar 2014, there usually is room for further refinement.

Given the appellate court's decision and the continuing uncertainty around the IPSA requirement, it is premature for registrants to retain an auditor. However, it is not premature to develop an auditor strategy. Many registrants intend to interview between three and five audit firms, typically their existing financial statement auditor, a Big 4 and/or a national or regional non-Big 4 CPA firm that does not perform their financial statement audit, and one or two non-CPA firms that could provide an IPSA under the performance audit standard. Meeting with multiple audit firms will provide greater visibility on both price and audit process, which will differ among audit firms since this continues to be an evolving area. It also will enable a quicker auditor selection if and when an audit is required.

Take EU Regulation into Account in Program Design

Compliance programs should be scalable for EU conflict minerals regulation. This advice applies in particular to internally developed software solutions. Although the EU regulation is expected to apply only to 3TG, a significant difference from the U.S. Conflict Minerals Rule is that it is expected to apply to conflict-affected and high-risk areas worldwide, rather than be focused solely on the DRC region.

Screen for Potential OFAC Compliance Issues

Because of the Conflict Minerals Rule, for the first time, many registrants are gathering and reporting information on their supply chains. Suppliers reported for calendar 2013 and 2014, and continue to report for calendar 2015, potential sourcing of minerals from Iran, North Korea and Sudan, as well as from specially designated nationals (SDNs) in other countries. In many instances, this information has in turn been publicly reported in registrants' filings and received attention in the press. For calendar 2014, 25 registrants listed North Korean gold in their CMRs.

The information also has been reported to commercial customers, who have then imposed additional due diligence requirements on the registrant.

To the extent not already in place, registrants should adopt procedures to screen for conflict minerals content from sanctioned countries and transactions with SDNs. In addition, conflict minerals compliance personnel should be trained to identify and internally report this information so that it can be further evaluated before being externally communicated. In most cases, these disclosures have unknowingly been made in filings and/or to customers.

Take a Holistic Approach to Supply Chain Compliance

Supply chain compliance continues to increase in complexity. For example, 2015 saw two new requirements relating to human trafficking. In the United States, a new Federal Acquisition Regulation rule took effect in March 2015 that imposes compliance and in some cases certification requirements on federal contractors and subcontractors. In the United Kingdom, the transparency provisions of the Modern Slavery Act (MSA) were adopted. The first disclosures under these provisions will be required starting in 2016.

The UK MSA, like the California Transparency in Supply Chains Act on which it is modeled, is a disclosure-only rule, meaning that it only requires a company to disclose what it is or is not doing, rather than to put in place specific compliance measures. However, as intended, these disclosure requirements are driving enhancements to substantive compliance procedures and engagement with suppliers around human trafficking issues.

And, although the California act took effect in 2013, this past year, it became a focus of the California Department of Justice and, more troubling, plaintiffs' law firms. The first comprehensive scoring of filings under the California act also was published in 2015.

Supply chain compliance requirements are not limited to just conflict minerals and human trafficking. In particular, companies rely on the cooperation of their suppliers to comply with an increasing number of environmental and product safety regulations.

To date, most companies have addressed supplier-facing regulations in a piecemeal fashion. In addition, responsibility for supply chain compliance often is split among different portions of the organization.

To increase efficiency and reduce regulatory risk, companies are increasingly starting to take a more holistic approach to their supply chain compliance. A holistic approach also can help to reduce NGO and SRI risk since these constituencies are increasingly drawing linkages between different CSR initiatives and disclosures.

Accordingly, if not already part of the 2016 compliance agenda, consider whether at least some aspects of supply chain compliance and/or disclosure should be harmonized.

If you would like to learn more about the issues in this Alert, please contact your usual Ropes & Gray attorney.

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