Association Connecting Electronics Industries

Summary of the Final SEC Rules on Conflict Minerals

On August 22, 2012, the Securities and Exchange Commission (SEC) voted in favor (3-2) of a long-awaited final conflict minerals regulation. Overall, the final regulation addresses most of the concerns raised by IPC. Although compliance will still be a significant burden for the industry, the final rule is an improvement over the proposed rule.

The final rule requires publicly traded companies to annually disclose information on the source of conflict minerals[1] contained in their products. This information will likely come from the supply chain, potentially requiring extensive inquiries on the origin of minerals. Although the final rule only applies to publicly traded companies, it is expected that the requirements will rapidly flow through the entire supply chain.

Companies subject to the conflict minerals requirements must disclose conflict minerals information on a calendar year basis, January 1–December 31, regardless of the issuer's fiscal year. Companies must provide this information using a new form called Form SD. Form SD must be filed with the SEC each year by May 31. **The first Form SD must be filed by May 31, 2014, with data from calendar year 2013.**

The final rule is divided into a three-step compliance process:

1) A company must determine whether it is subject to conflict minerals requirements;
2) If yes, the company must conduct a reasonable country of origin inquiry to determine if the "necessary conflict minerals[2]" used originated in the covered countries[3] or are from recycled or scrap materials.
3) If a company determines, or has reason to believe, that the conflict minerals originated in the covered countries and are not, or may not be, from recycled or scrap sources, it must exercise due diligence on the source and chain of custody of conflict minerals and may need to provide a Conflict Minerals Report (CMR).

Issuers required to file a CMR will include the CMR as an exhibit to Form SD; it will not be included in the body of the report. According to the SEC, filing Form SD (as opposed to Form 10K, as originally proposed) does not create strict liability for filed information. Instead, it states that a person shall not be held liable for misleading statements in a filed document if it can be

[1] The term "conflict minerals" is defined in the final rule to include cassiterite, columbite-tantalite, gold, wolframite, and their derivatives which are limited to tin, tantalum and tungsten, unless the Secretary of State determines that additional derivatives are financing conflict in the covered countries, in which case they are also considered "conflict minerals;" or any other minerals or their derivatives determined by the Secretary of State to be financing conflict in the covered countries.

[2] The SEC uses the term "necessary conflict minerals" to describe conflict minerals that are necessary to the functionality and production of a product.

[3] The SEC uses the term "covered countries" when referring to the Democratic Republic of the Congo and adjoining countries, currently Angola, Burundi, Central African Republic, the Republic of the Congo, Rwanda, South Sudan, Tanzania, Uganda, and Zambia.

established that the person acted in good faith and had no knowledge that the statement was false or misleading. Issuers will be required to provide a link in their disclosure to their CMR on their website. The CMR must be posted to the issuer's website for one year. Issuers will not be required to maintain reviewable business records, which is a change from the proposed rule. The new Form SD will contain a "specialized disclosure report" where issuers will describe efforts taken during its reasonable country of origin inquiry. The final rule does not require a physical label on any product stating whether it is "DRC Conflict Free" or "Not DRC Conflict Free."

Existing Inventory
Conflict minerals already in the supply chain are excluded from disclosure requirements. Conflict minerals "outside the supply chain" prior to January 31, 2013 are excluded. Conflict minerals are considered outside the supply chain 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 has not been smelted or fully refined is located outside of the covered countries

Economic Analysis
The SEC revised its estimate of the cost of implementing the final rule.. The SEC's revised estimates more accurately represent the impact of the regulation not only on issuers, but also on the supply chain. In the final rule, the SEC states that the initial cost of compliance is approximately $3–4 billion, with the annual cost of ongoing compliance somewhere in the range of $207–609 million. In addition, the SEC acknowledged that much of the cost of the final rule will fall on non-reporting companies that are part of reporting companies' supply chains.

The remainder of this summary goes into further detail on each compliance step.

Step 1: Determining if Subject to Reporting Requirements

The final rule applies to a company that uses conflict minerals or their derivatives if:
1) The company files reports with the SEC under the Exchange Act, and
2) The minerals are "necessary to the functionality or production" of a product manufactured or contracted to be manufactured by the company.

The SEC did not to provide a definition for several key terms used throughout the final rule. Instead, the SEC has provided guidance to help issuers determine the applicability of the requirements under the final rule. The SEC states that the flexibility provided will allow issuers to tailor their due diligence to their individual needs, thereby reducing the cost of the regulation.

"Manufacture" was not defined; however the SEC states that the term does not describe an issuer that only services, maintains, or repairs a product containing conflict minerals. "Manufacture" also does not include mining or contracting to mine.

"Contract to manufacture" applies to companies that have "actual influence" over the manufacturing of a product. A company that contracts the manufacturing of components for their products and has influence over the materials, parts, ingredients or components to be included in

any final product that contains necessary conflict minerals is subject to disclosure requirements. A company is not considered to have actual influence over the manufacturing of a product if it:

- 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.

"Necessary to the functionality" applies to conflict minerals that are:

- Contained in the product or any component of the product
- Intentionally added to the product or any component of the product
- Necessary to the product's generally accepted function, use, or purpose.
    - A product may have multiple generally accepted functions, uses or purposes
    - If a conflict mineral is incorporated into a final product for purposes of ornamentation, decoration or embellishment, that conflict mineral would be considered necessary to the functionality of the product.[4]

The SEC provides the following supplemental information to help companies determine if they must comply with the conflict minerals regulation:

- Conflict minerals information is required for the calendar year in which the manufacturing of the product that contains necessary conflict minerals is completed.
- Only a conflict mineral contained in the product is considered "necessary to the functionality or production" of that product. The final rule does "not consider a conflict mineral used as a catalyst or in another manner in the production process of a product to be 'necessary to the production' of the product if that conflict mineral is not contained in the product."[5]
- A conflict mineral in a physical tool or machine used to make a product is not considered "necessary to the production" of the product and not subject to disclosure requirements.
- The final rule does not provide a *de minimis* exception. If a trace amount of the conflict mineral is found in the product, then the conflict mineral is considered to be "necessary to the production" of the product and therefore subject to disclosure requirements.

Step 2: Reasonable Country of Origin Inquiry – Determining Source of Conflict Minerals

A reasonable country of origin inquiry (RCOI) is the procedure for determining whether a necessary conflict mineral originated in the covered countries. The SEC does not explicitly define the necessary criteria for an acceptable RCOI. A RCOI is based on a reasonable design and good-faith inquiry. An acceptable RCOI will depend on each issuer's particular facts and circumstances and available infrastructure at a given time. The SEC does not provide an explicit definition in order to give issuers flexibility and reduce overall compliance costs. The SEC provides general standards for issuers to use as guidance when designing and conducting a RCOI. These standards include:

[4] For example, gold in a necklace is considered necessary to the functionality of the necklace, because the purpose of the necklace is ornamentation.

[5] See page 89 of *Conflict Minerals,* Rel. No. 34-67716 (Aug. 22. 2012("Adopting Release").

1) The RCOI must be reasonably designed to determine whether the necessary conflict mineral originated in the covered countries or from recycled or scrap sources and must be performed in good faith.
2) When conducting a RCOI, the issuer should seek and obtain reasonably reliable representations indicating the facility at which its conflict mineral was processed and demonstrate that the necessary conflict mineral did not originate in the covered countries or came from recycled or scrap sources[6].
3) An acceptable RCOI does not need to contain responses from all suppliers. If the issuer follows standard #1, and in doing so receives responses that indicate the necessary conflict mineral is not from the covered countries, the issuer may claim "DRC conflict free" provided it does not ignore warning signs from its suppliers.

Results of the RCOI will determine whether an issuer must conduct due diligence on the source and chain of custody of necessary conflict minerals, file a CMR, and conduct an independent private sector audit of the CMR.

If the RCOI determines either that the company (1) knows that the minerals did not originate in the covered countries or are from scrap or recycled sources, or (2) has no reason to believe that the minerals may have originated in the covered countries and may not be from scrap or recycled sources, then the company must disclose its determination by providing a brief description of the RCOI it undertook and the results of the inquiry on Form SD. The issuer is not required to exercise due diligence on its conflict minerals source or chain of custody or file a CMR. The company would be required to make its description publicly available on its website, and provide the Web address of that site in Form SD.

If the RCOI determines either that the company (1) knows that the minerals did originate in the covered countries or are not from scrap or recycled sources, or (2) has reason to believe that the minerals may have originated in the covered countries and may be from scrap or recycled sources, or (3) is uncertain whether or not the minerals originated in the covered countries or are from scrap or recycled sources, then the company must conduct due diligence on the source and chain of custody of the necessary conflict minerals, file a CMR, and conduct an independent private sector audit of the CMR. The section on Step 3 goes into further detail about due diligence and CMRs.

Indeterminate Category and a Phase-In Period

The final rule allows companies to disclose the origin of the necessary conflict minerals as "DRC Conflict Undeterminable" for an interim period of two years; four for small companies[7]. This phase-in period applies to the 2013 and 2014 reporting periods; 2013-1016 reporting periods for small companies. Companies that declare their necessary conflict minerals as "DRC Conflict Undeterminable" are required to conduct due diligence on the source and chain of custody of its conflict minerals and submit a CMR. The company, however, does not need to have its CMR audited by an independent third party.

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[6] The SEC states that these representations can, and will likely, come from suppliers. If so, the issuer must have reason to believe the representations are true.
[7] A small reporting company is defined in Rule 12b-2 {17 CFR 240.12b-2] under the Exchange Act.

Recycled and Scrap Materials

The final rule allows for different treatment of conflict minerals from recycled or scrap sources. The final rule states that conflict minerals are considered to be from recycled or scrap sources if they are from recycled metals, which are reclaimed end-user or post-consumer products, or scrap processed metals created during product manufacturing.

If a company's conflict minerals are derived from recycled or scrap sources rather than from mined sources, the company's products containing such minerals are considered "DRC conflict free."

For gold — If a company cannot reasonably conclude after its inquiry that its gold is from recycled or scrap sources, then it is required to undertake due diligence in accordance with the OECD Due Diligence Guidance, and obtain an audit of its Conflict Minerals Report.

For tin, tantalum, and tungsten — If a company cannot reasonably conclude after its inquiry that its minerals are from recycled or scrap sources — until a due diligence framework is developed — the company will be required to describe the due diligence measures it exercised in determining that its conflict minerals are from recycled or scrap sources .

Step 3: Supply Chain Due Diligence and Conflict Minerals Report Content

Due Diligence

An issuer must exercise due diligence on its conflict minerals source(s) and chain of custody and provide a CMR if the issuer knows or has reason to believe that it has necessary conflict minerals that originated in the covered countries and did not come from recycled or scrap sources.

Due diligence measures used must conform to a nationally or internationally recognized due diligence framework. Currently, the only framework available is the OECD due diligence guidance.

If an issuer determines, based on its due diligence that its necessary conflict minerals did originate in the covered countries and did not come from recycled or scrap sources, then the issuer is required to submit a CMR.

If at any point during the exercise of due diligence, the issuer determines that its conflict minerals did not originate in the covered countries or came from recycled or scrap sources, the issuer is not required to submit a CMR. However, the issuer would still be required to submit a specialized disclosure report disclosing its determination and briefly describing the RCOI and due diligence efforts it undertook as well as the results of those efforts, and why the issuer believes its conflict minerals did not originate in the covered countries or came from recycled or scrap sources.

Conflict Minerals Report

The final rule requires issuers who must file a Conflict Minerals Report (CMR) to disclose in its specialized disclosure report, under a heading entitled "Conflict Minerals Disclosure," that a CMR is provided as an exhibit and to provide the website address of where the CMR is publicly available.

During the phase-in period, companies may categorize their products as: DRC Conflict Free, Not DRC Conflict Free, or DRC Conflict Undeterminable.

"DRC Conflict Free" may mean that the minerals originated in the covered countries, but did not finance or benefit armed groups. If an issuer determines that its products are "DRC Conflict Free," then the company must undertake the following audit and certification requirements:

- Obtain and independent private sector audit of its CMR and certify that it obtained such an audit
- Include the audit report as part of the CMR
- Identify the auditor in the CMR

If a company determines that its products are "Not DRC Conflict Free," then, in addition to fulfilling the audit and certification requirements, the company must describe the following in its CMR:

- The products manufactured or contracted to manufacture that are found to be "Not DRC Conflict Free"
- The facilities used to process the conflict minerals in those products
- The country of origin of the conflict minerals in those products.
- The efforts to determine the mine or location of origin with the greatest specificity possible

Only during the temporary two-year period (or four years for small businesses) can companies determine that their products are "DRC Conflict Undeterminable." If a company is not able to determine whether its products contain minerals that financed or benefited armed groups in the covered countries, then the company must include descriptions of the following in its CMR:

- Its products that are "DRC Conflict Undeterminable"
- The facilities used to process the conflict minerals in those products, if known.
- The country of origin of the conflict minerals in those products, if known.
- The efforts to determine the mine or location of origin with the greatest specificity possible.
- The steps taken or that will be taken to mitigate the risk that its necessary conflict minerals benefit armed groups, including any steps that would improve due diligence.

An independent private sector audit is not required for companies with products that are "DRC Conflict Undeterminable."

Audit Requirements and Objectives

The final rule states that the auditing 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…is in conformity with…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…is consistent with the due diligence process it undertook."

The final rule does not require an audit of the entire CMR; the final rule limits the audit to sections of the CMR that discuss the design of the issuer's due diligence framework and the due diligence measures the issuer performed.

The critical point contained in this section of the final rule is that the audit is required to assess not only the design, but also the performance of the due diligence undertaken. The audit is not required, however, to assess the conclusion reached as a result of the due diligence framework. The final rule does not include standards for the independent audit. GAO has indicated to the SEC that they do not plan to use new auditing standards for purposes of implementing Section 1502, and therefore, existing GAO auditing standards will be applicable.

According to the GAO auditing standards, auditors must be "licensed certified public accountants, persons working for a licensed CPA firm or for a government auditing organization, or licensed accountants in states that have multi-class licensing systems that recognize licensed accountants other than CPAs." The SEC states that this broad definition of an auditor will increase the number of auditors allowed to perform the audit, thereby decreasing the cost of the audit because there will be more competition among auditors.