In six months, companies must file a report with the SEC to satisfy new regulations, so-called Conflict Minerals. Companies that fail to plan ahead could face financial risk as well as damage to their brands. But those that do may well enjoy a competitive edge.

Keeping ‘Conflict Minerals’ Out of the Supply Chain

By Howard Heppelmann
Globally, manufacturers and their suppliers must contend with a large, diverse, and constantly evolving set of supplier- and material-focused regulations and related customer obligations. Traditionally, the common drivers of these regulations and requirements have revolved around environment, health, and safety. Increasingly, however, these are being joined by a new generation of drivers that focus on addressing corporate social responsibility issues such as economic inequalities, unfair and inhumane labor practices, and even armed conflict. These new requirements are forcing manufacturers to transform the processes, systems, and data that enable effective collaboration with their supply chains.

For example, manufacturers registered with the SEC will, beginning in May 2014, be required to submit a new annual filing that discloses details about the presence of Conflict Minerals within their products and the steps they have taken to discover information about the origin of these materials. At that time, manufacturers must begin reporting whether their products (including the components provided to them by their supply chains) contain tin, tantalum, tungsten, or gold. These are commonly referred to as 3TG materials. These materials are used in a very broad range of products within the electronics, medical device, consumer goods, industrial equipment, automotive, aerospace and defense, and retailmarkets.

In order to comply with the law—part of the Dodd Frank Wall Street Reform act of 2010—companies must determine if any 3TG minerals in their products were sourced from the Democratic Republic of Congo (DRC) or one of the surrounding countries, and if the mining of these minerals funded armed conflict. The intent of this ruling is to cut off the flow of funds to armed groups that are responsible for atrocities in the region.

To be clear, the rule does not ban the use of conflict minerals outright. Instead, it requires disclosure aimed at "naming and shaming" manufacturers as a means to persuade them to use conflict-free sources.

Who, exactly, does this ruling impact? It applies to any company filing with the SEC that requires any of the 3TG materials either for the production or function of its products, including manufacturers and companies that contract another organization to manufacture their products. The SEC expects that approximately 6,000 companies — 5,994, to be precise — will be required to submit a report in May 2014 as ‘issuers’ under the SEC rule. This includes roughly 5,551 companies filing a Form 10-K, 377 companies filing a Form 20-F, and 66 companies filing a Form 40-F, with the latter two classifications applying to foreign-based companies that are registered with the SEC.

**Impact on the Supply Chain**

These rules also impact vast numbers of suppliers that will need to provide their SEC-registered customers with information about the sources of 3TG minerals contained in the components, products, and materials they supply in order for their customer to meet their SEC reporting obligations. A recent Government Accountability Office (GAO) report to Congress, “SEC Conflict Minerals Rule - Information on Responsible Sourcing and Companies,” states that the SEC estimates 278,000 suppliers will be impacted by the rule.

Suppliers can expect to receive conflict mineral disclosure requests from many of their customers. Thankfully, an industry standard has emerged that will help suppliers by allowing them to use a single format to report Conflict Minerals information. This particular template, the EICC-Gesi (Electronic Industry Citizenship Coalition and the Global e-Sustainability Initiative) standard, also known as the Conflict Minerals Reporting Template (CMRT), has become the de-facto way to provide data in a common format to support the SEC framework for compliance. The EICCGesi template was designed to support the SEC requirements by following the Organization for Economic Co-operation and Development’s (OECD) guidelines for due diligence reporting, the latter being formally approved by the Government Accountability Office (GAO), the enforcement body for SEC rules, as the internationally recognized standard for conflict minerals due diligence. In order to meet customer requirements for this information, suppliers, like their SEC-registered OEM customers, will need to determine which of their products have potential conflict minerals in them. This means they will need to investigate the country of origin of 3TG materials they use and conduct the same due diligence required of SEC-registered companies with their suppliers. Not surprisingly, this will have a ripple-through effect of reporting requirements reaching all the way back to the smelters.

Suppliers that are slow to respond, fail to provide the required information, or are unable to substantiate the information they do provide can expect to be penalized by their customers with reduced supplier scores, loss of preferred status, and even lost business.

The cost associated with Conflict Minerals data collection, reporting, and ongoing compliance is universally expected to be significant. The SEC itself estimated that first-year reporting efforts will cost affected organizations between $3 billion and $4 billion, with recurring annual costs in the range of $200 million to $600 million. Tulane University Law School’s Payson Center for International Development is forecasting first-year costs in the realm of $8 billion.

Research by the National Association of Manufacturers, the SEC, Tulane University, and the industry group IPC – Association Connecting Electronics Industries – indicates large companies could spend between $250,000 and $2 million for their 2014 conflict minerals filings. An IPC study estimates that, for the average company, the labor costs alone will be more than $300,000 per year.

The two key drivers of those estimated costs are the scale of effort required to gather and validate the data from suppliers and the SEC and customer reporting obligations related to linking those material records to products issued to the market.

**What’s at Stake?**

There are no specific fines or penalties attached to the SEC’s Conflict Minerals requirements. The goal

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Howard Heppelmann is General Manager, Supply Chain Management at PTC. In this role, Mr. Heppelmann has responsibility for the leadership and financial management of PTC’s SCM market segment including market analysis, solution definition, solution marketing, and strategic business and customer development activities.
of Conflict Mineral law is to “name and shame” companies for their sourcing strategies with regards to conflict minerals. The conflict minerals reports will become part of public filings required of all manufacturers registered with the SEC. These manufacturers must also post this information, along with a description of products impacted, on their websites. The results will be scrutinized by journalists, Non-Governmental Organizations (NGOs), and consumers with significant potential for brand impact.

The “Slavery Is Not A Game” campaign, carried out against Nintendo by the activist group Walk Free in June, 2013, is an excellent example of the brand threat facing companies that do not develop a Conflict Minerals strategy and policies or announce a clear plan to do so in the near future.

OEMs and suppliers that establish a robust and efficient process for complying with the Conflict Minerals Rule will not only protect their brands against risk but also create future-ready systems and processes that leverage compliance as a competitive advantage.

Similar regulations are already pending in the EU and Canada. And, as stated at the outset of this article, conflict minerals requirements are just one part of an increasingly complex global regulatory environment. A proper framework for conflict minerals compliance will position manufacturers to respond to future supplier and material-focused regulations.

Perhaps most importantly, companies – suppliers and OEMs – must consider if strategic customers are tying Conflict Minerals compliance disclosure and status to future purchase decisions or supplier rankings. Companies that choose to ignore the issue will place future contracts and revenues at significant risk. By shaping their product development and sourcing strategies to address the risk posed by conflict minerals in 2014, companies will resolve potential compliance issues before they become costly problems.

The Process

Determining the country of origin and source of 3TG materials can be a lengthy process. What are the steps required by the SEC of issuers and suppliers to determine the origin of the minerals in their products? At the most basic level, issuers must clearly state the processes it uses to collect the required information; follow the framework and due-diligence guidance set forth by the SEC, GAO and OECD; establish baselines for its first SEC report; and demonstrate continuous improvement in subsequent reports.

The SEC compliance process is illustrated in the diagram.

Step 2: Determine Applicability. Companies must first determine whether any of the products they make contain any 3TG minerals (regardless of the origin of those minerals.) Typically, strategies for identifying parts, products, and suppliers with 3TG materials are based on reviews of part commodity codes, supplier classifications, supplier spend, and/or other material compliance disclosure information that a company may possess. If none of the products in a company contain 3TG materials, no filing is required.

Step 2: Conduct Reasonable Country of Origin Inquiry. If their products contain 3TG minerals, issuers need to determine whether the minerals in question came from the DRC region. (See diagram 2.) The SEC defines a ‘Reasonable Country of Origin Inquiry’ (RCOI) as one that allows companies to rely on statements from their suppliers about the country of origin, provided the issuers “take into account any applicable warning signs or other circumstances indicating that its conflict minerals may have originated in the covered countries or did not come from recycled or scrap sources.”

The industry standard for capturing supplier disclosures— including country-of-origin information in support of the SEC reporting framework — is the EICC/GeSI Standardized Conflict Minerals Reporting Template (CMRT). The template provides suppliers with a way to dramatically reduce or eliminate the number of potential form variations that they would otherwise need to use to satisfy multiple customer-specific formats. Additionally, companies should seek to automate the request, receipt, and validation of supplier EICC/GeSI declarations to create a cost-efficient and scalable process.

If, after performing the RCOI, a company concludes that none of the 3TG minerals in its products were from the DRC region, the organization need only report why it believes so and the processes it put into place to make the determination.

Step 3: Due Diligence

If the 3TG minerals in a manufacturer’s products come from around the DRC, it will need to engage in an approved due diligence framework to determine whether the mine sources were conflict-free. In determining this, the SEC final rule requires that an issuer follows a nationally- or internationally- recognized due diligence framework. The OECD framework therefore has been widely adopted as the standard approach for meeting due diligence obligations.

The OECD framework requires companies to establish strong management systems in order to identify the smelters used in their supply chains and to maintain compliance records for at least five years. In addition, the OECD framework requires companies to have evidence of an independent third-party audit of the smelter/refiner’s due diligence program using tools such as the Conflict Free Smelters (CFS) program.

The Electronic Industry Citizenship Coalition (EICC) and the Global e-Sustainability Initiative (GeSI) have created the

Getting to the Source

Determining the country of origin and source of 3TG materials can be a lengthy process.
CFS assessment program in which an independent third party evaluates smelters’ and refiners’ procurement activities to determine whether or not all ores they processed have originated from conflict-free mines. The EICC/GeSI Standardized Conflict Minerals Reporting Template catalogues smelters for use by suppliers. This information can be used in conjunction with the CFS assessment to determine if the mine sources were conflict-free. 

**Step 4: Determine Status.**
Based on information collected in the above steps, manufacturers then must assess their suppliers, parts, and products to arrive at a Conflict Minerals compliance status. For the first two SEC reporting cycles, the implementation of the law includes the option of an “undeterminable” status which signifies that most manufacturers will be immediately unable to determine the source of the 3TG minerals in their products. The undeterminable status is a practical admission that tracing materials to their original source is a difficult task and it will require some time for the supply chain to align, adopt, and implement the standards that will enable accessibility to the information required. For all but the smallest SEC-registered companies, the “undeterminable” period ends with their May 31, 2016 SEC filing.

**Step 5: Report to the SEC, Customers, and Auditors.**
If a company has reason to believe that 3TG minerals in its products may have been sourced from the DRC region, the company is required to file a Form SD and a Conflict Minerals Report with the SEC and to post this information on its company website. Manufacturers will also need to create reports for their customers, as well as reports that can be used to streamline internal and third-party audit processes.

**Best Practices**
Are you collecting data and developing new policies around Conflict Minerals? Are you evaluating alternate supplier sources? As with any new regulation or requirement, organizational capabilities must be built. But building the right team and organizational strategies is no small task. To be successful, companies must reach across functional boundaries and build a systematic, scalable, adaptable, automated approach. Here are some steps that will be necessary to create such a process:

- **Assemble a Cross-Functional Team:** This is not a typical compliance exercise. A team that includes representatives from legal, supply chain, finance, audit, compliance, sales, and engineering functions will be required.
- **Establish a Holistic Materials Compliance Program and Platform:** Beyond the Conflict Minerals ruling, manufacturers are subject to a broad and growing array of regulations targeting materials, products, and suppliers. Compliance with applicable regulations is required in order to legally sell in the U.S., EU, China, and other significant markets. The capabilities and process requirements needed to comply with Conflict Minerals regulations are very similar to those required by REACH, RoHS, China RoHS, ELV, and hundreds of other government regulations and related customer obligations. Companies that wish to minimize the rising cost of compliance while turning the obligation into a competitive advantage should establish a common program, platform, and set of processes to address all areas of supplier and material compliance;
- **Create an Automated Approach:** Manufacturers with extensive product portfolios and/or supplier networks face an exponential explosion of effort. Manufacturers managing large numbers of products, parts, and suppliers should deploy a technology platform that can be used to automate data collection, validation, and internal, customer, and government compliance reporting.
- **Integrate with Product Development and Supplier Management Processes:** Compliance processes and the systems supporting them should be well integrated into the overall processes used for developing products and managing suppliers. Ultimately, compliance with Conflict Minerals regulations should be managed as an output of core product development processes, including new part introduction, supplier qualification, and engineering change management. When performed during product development, these compliance processes can identify and resolve issues before they become costly problems in production;
- **Develop Policies and Procedures:** The retroactive Conflict Minerals filing required by the SEC in 2014 and the corresponding work effort represent just first steps in an ongoing process. Forward-thinking organizations will establish policies that require all new suppliers to have sound Conflict Minerals policies and to provide the EIC/GeSI forms in order to be qualified as suppliers.

**The Opportunity to Achieve Competitive Advantage**
Do you understand the new rules under which your organization will have to play? Have you thought about the processes that will lead to efficient compliance?

Many manufacturers may have delayed their preparation for the first Conflict Minerals filing deadline in the hopes that the requirements would be overruled or, at the very least, watered down. Others may not be sure where to start. Meanwhile, the May 2014 filing deadline is quickly approaching.

Manufacturers that build robust organization capabilities to address the SEC Conflict Minerals reporting requirements will gain more than just compliance with the regulation. These companies will expend far fewer resources to achieve compliance, more easily keep up with ever-changing regulations and product requirements, reduce the risk of fines and damage to their brand image, and protect and enhance revenue streams. Ultimately, these manufacturers will free up resources that can be used to design better products for their customers and improve corporate performance.

Companies such as Intel, Motorola, and Microsoft have already made their Conflict Minerals sourcing policies public and are involved in industry groups that are researching the challenge of responsible minerals extraction. Manufacturers that similarly approach the issue of conflict minerals as an opportunity will be positioned for competitive advantage.