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EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

Accompanying the document

Proposal for a Regulation of the European Parliament and of the Council

setting up a Union system for supply chain due diligence self-certification of responsible importers of tin, tantalum and tungsten, their ores, and gold originating in conflict-affected and high-risk areas

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Introduction and Context

Introduction

Armed groups in conflict regions finance their activities *inter alia* from the proceeds of extraction and the trade of minerals which later enter the global supply chain. Consequently, business operators further down the supply chain run the risk of supporting armed activities through their purchases of mineral ores or derivatives and have an interest in sourcing from such regions in a responsible manner.

The concept of *responsible sourcing* is referred to in the updated OECD Guidelines for Multinational Enterprises and in line with the objectives of the United Nations Guiding Principles on Business and Human Rights. Both aim at encouraging businesses to verify through an ongoing process known as due diligence, that their commercial activities are not contributing to conflict.

Policy context

Responsible sourcing of minerals from conflict zones has received considerable attention from the international community over the past few years. The challenge posed by the desire to minimise the financing of armed groups and continuing to source legitimately from the region, has been taken up by governments and international organisations together with business communities and civil society organisations.

As a result, there are presently a number of prescriptive due diligence frameworks in place:

- In 2010, the United States passed the Dodd Frank Wall Street Reform and Consumer Protection Act (US DFA) whose section 1502 requires companies listed on US stock exchanges and using "conflict minerals" to declare the origin of such minerals used in their supply chain as well as to perform due diligence as appropriate.

- Based on the *OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas* legislation is in place in the Democratic Republic of Congo (DRC) and Rwanda. A few other countries (Uganda, Burundi) are preparing the transposition of the *OECD Guidance* into law. Moreover, Colombia and Côte d'Ivoire are considering participating in the implementation programme of the OECD.

On 7 October 2010, the European Parliament passed a Resolution calling for the EU to legislate along the lines of the US "conflict minerals" law. In view of this political demand, this report assesses the different policy options which would best take forward this request for EU legislation in collaboration with the European Parliament.

Problem Definition

The main problems relating to the responsible sourcing of minerals originating from conflict-affected and high-risk areas as identified by stakeholders in the public consultation include:

(i) *the continued financing of armed groups via the (proceeds of) extraction and trade of minerals in conflict-affected and high-risk areas:* the problem is prevalent in countries rich in natural

resources but vulnerable to armed conflict across the whole or part of their territory. While the issue arises world-wide, the impact assessment focuses primarily on the well documented case of the eastern DRC and neighbouring countries, which has received high-profile attention by advocacy groups these last 10-15 years;

(ii) *the implementation challenges faced by EU downstream enterprises attempting to sustain legitimate trade, or voluntarily, performing due diligence within the current frameworks:* due to a number of problems (e.g. opaque supply chain, confidentiality concerns, lack of leverage over smelters/refiners, lack of awareness or ethical concerns) EU companies have difficulties complying with due diligence requirements on the basis of customers' requests;

(iii) *market distortion in the form of reduced demand and prices in formal sector for minerals from the DRC and other Great Lakes Region countries:* since 2010 the DRC is experiencing a reduction in formal export volumes, lower prices and increase in informal trade of tin, tantalum, tungsten ores and gold and fewer opportunities to export to US or EU clients. The decline can be attributed to business choices not to source any more from the Great Lakes Region by operators affected directly or indirectly by the Dodd Frank Act.

Objectives

Specific objectives

1. Increase the proportion of EU and global smelters/refiners that perform due diligence.
2. Raise the level of public accountability for due diligence performance (and level of compliance) by EU and global smelters.
3. Increase the ability of EU downstream companies to successfully identify smelters/refiners.
4. Improve the bargaining position of EU downstream companies (on due diligence) vis-à-vis companies further back in the supply chain.
5. Improve awareness of due diligence, of the importance of due diligence compliance, and of ethical dimensions throughout the supply chain – both inside and outside the EU.
6. Increase the uptake (performance) of due diligence practices by downstream companies.
7. Offset/reduce the adverse commercial incentive created or exacerbated by US DFA.

Operational objectives

1. Provide enhanced visibility and transparency for due diligence practices (and level of compliance) of EU and global smelters.
2. Raise awareness of due diligence, ethical dimensions, and the importance of improving due diligence compliance with governments of main non-EU smelters/refiners.
3. Empower downstream users by providing a mechanism to identify due diligence compliant operators (including smelters), and thus to facilitate switching of suppliers.
4. Introduce certainty and transparency in the supply chain nearer to downstream users.
5. Promote increased awareness of due diligence and ethical dimensions among EU operators.
6. Create additional financial incentives in order to promote/support due diligence practices among downstream users.
7. Support the uptake of OECD Guidance among smelters/refiners willing to source in conflict-affected areas.
8. Support demand from conflict-affected areas: facilitate switching by EU operators to due diligence compliant smelters/refiners sourcing in those areas.

Policy Options

The following range of policy options has been considered:

Option 1 – Standalone EU Communication

This option consists of the following measures to be included in a joint Communication of the Commission and of the High Representative:

(i) National Contact Points (NCPs) and the Enterprise Europe Network (EEN) would advocate the uptake of the OECD Guidance; (ii) EU public procurement: the application of performance clauses in Commission and EU Member States' public procurement contracts for relevant products; (iii) financial assistance to the existing OECD programmes; (iv) Commission support to 'Letters of Intent' by the European industry, and (v) government-to-government actions.

Option 2 – "Soft-law" approach

This option combines the measures described under Option 1 with a Council Recommendation that would be instrumental in raising awareness of and promoting the voluntary uptake by EU enterprises of the OECD Guidance notably for those enterprises that are not already subject to a mandatory third country scheme.

Option 3 – Regulation establishing obligations under an "EU responsible importer" certification based on OECD Guidance - VOLUNTARY

This option combines the measures described under Option 1, with a Regulation targeting all EU importers of tin, tantalum and tungsten ores and metals, and gold, regardless of the origin of the products. The Regulation relies on the OECD Guidance to define obligations for EU importers that opt to be self-certified as responsible importers of tin, tantalum and tungsten ores and metals, and gold, on the basis of a self-declaration of compliance.

Although the scheme is voluntary, EU importers choosing self-certification are obliged to integrate all elements of the OECD Guidance in their management system by: (i) maintaining a system of controls and transparency over the mineral supply chain, which includes *inter alia* the mine of mineral origin and the smelter/refiner; (ii) identifying and assessing risks in the supply chain against the OECD model supply chain policy; (iii) designing and implementing a strategy to respond to identified risks; (iv) obtaining independent third-party audit assurance of supply chain due diligence of the EU importer; and (v) reporting publicly on supply chain due diligence.

The EU self-certified importer is required to disclose annually to Member States' competent authorities the identity and geographical location of the smelter/refiner in its supply chain. On this basis, an EU list including responsible smelters/refiners would be drawn up.

The scheme will be evaluated after three years and the results will be used for decision-making needs on the future of the EU approach and for amendments to the regulatory framework, making it mandatory, if appropriate and on the basis of a further impact assessment.

Option 4 – Regulation establishing obligations under an "EU responsible importer" certification based on the OECD Guidance – MANDATORY

This option combines the measures described under Option 1, with a compulsory version of the Regulation described in Option 3 under which all EU importers of tin, tantalum and tungsten ores and metals, and gold, would be subject to the obligations defined under the Regulation.

Option 5 – Directive establishing obligations for EU-listed companies based on the OECD Due Diligence Guidance

This option combines the measures described under Option 1, with a Directive targeting almost 1,000 EU-listed companies using tin, tantalum, tungsten and gold, regardless of origin, in their supply chain.

The Directive would define the obligations for EU-listed companies to integrate the "five-step" OECD Guidance framework in their management system by (i) maintaining a system of controls and transparency over the mineral supply chain, which includes the mine of mineral origin and the smelter/refiner; (ii) identifying and assess risks in the supply chain against the OECD model supply chain policy; (iii) designing and implementing a strategy to respond to identified risks; (iv) obtaining an independent third-party audit of supply chain due diligence of the EU-listed company; and (v) reporting publicly on supply chain due diligence.

EU-listed companies should disclose the outcome of the independent third-party audit.

Option 6 – Prohibition of imports when EU importers of ores fail to demonstrate compliance with OECD Guidance) – import ban

This option consists of the measures described under Option 1, and in addition it would require EU importers to mandatorily demonstrate compliance with the OECD Guidance. Providing evidence on compliance to Member States' customs authorities, importers will be eligible to access the EU market.

This option would follow the approach taken by the Kimberley Process Certification Scheme targeting the trade in rough diamonds and Council Regulation 2368/2002 of 20 December 2002 based on Article 133 EC (now Article 207 TFEU) which sets out the rules applicable for imports and exports of rough diamonds. In this case an international agreement supports the importation ban for so called "conflict diamonds".

Impact Analysis

Option 1 – no change

This option is expected to moderately impact the uptake of due diligence practices by downstream operators but is only marginally expected to increase the proportion of EU and global smelters/refiners performing due diligence. The contribution to the reduction of the distortion in the market for minerals from the Great Lakes Region is addressed to a limited extent. Overall the impact on reducing the funding of armed groups from proceeds of minerals' extraction and trade in conflict zones is expected to be limited.

Option 2

The effectiveness of this option is comparable to Option 1. However, it could be expected that the added value of a Council Recommendation would reside in the improved visibility that a 'soft law' option would entail for the EU to promote due diligence.

Option 3

Overall the effectiveness of this option in achieving the objectives set out above is high, as all of them are met. By focussing on importers, who are only a few steps removed from the mines where minerals are extracted, the scheme is applied at an effective point in the supply chain. This option improves the ability of EU downstream operators to comply with existing due diligence frameworks, including US DFA. It also contributes to the reduction of funding of armed groups from proceeds of minerals' extraction and trade in conflict affected areas and reduces the market distortion for minerals from the Great Lakes Region.

Due to the voluntary nature of this self-certification, the overall cost of due diligence compliance for EU importers would depend on the participation rate and the due diligence cost in relation to the company turnover. The costs are nevertheless expected to be manageable – if not minor – over the long run for most companies. Under the scheme, an importer opting for self-certification is obliged to pass on to clients due diligence information while duly respecting business confidentiality concerns. Downstream operators should gain by this requirement which allows them to minimise the costs for their own due diligence needs. The availability of incentives as offered in Option 1 as well as the annual publishing by the Commission of a list of smelters that perform due diligence should enhance interest in the scheme.

This option is effective in that it gives a positive signal to business whose decisions to source or not in conflict-affected areas have a direct impact on demand for minerals. The reactivation of legitimate business connections opens up new positive opportunities on the ground including increased governments revenues, formalised mining sectors, more sustainable development and environment, increased prospects for private investment and jobs in mining communities that in turn stimulate local economies.

Option 4

This option improves the ability of EU downstream operators to comply with existing due diligence frameworks, including US DFA. It also contributes to the reduction of funding of armed groups from proceeds of minerals' extraction. One fundamental difference with respect to Option 3 is that it is not expected to reduce the market distortion for minerals from the Great Lakes Region caused by profoundly risk averse sourcing decisions.

While the participation rate of EU firms can be increased with a mandatory self-certification scheme, this option does not necessarily mean that the overall benefits would be maximised. Indeed, under both Options 3 and 4, what the scheme does is provide a framework for importers sourcing in conflict-affected regions to source responsibly and have their efforts validated by Member State competent authorities. The scheme cannot however compel EU importers to source from conflict-affected areas. Therefore, in a mandatory scenario, the risk of importers seeking alternative sourcing is higher than in Option 3. This assessment is supported by the experience of developments on the ground since 2010 as explained in the Problem Definition.

Option 5

This option improves the awareness of due diligence among EU downstream companies at the expense of high implementation costs for companies while not contributing to the implementation challenges to take up the due diligence effectively. This is because downstream companies are further removed from the entry point of minerals into the EU market, sometimes with dozens of suppliers in between. The further the position of the company in the supply chain, the higher the cost of implementing due diligence. As such, the reduction of funding of armed groups from proceeds of minerals' extraction is not expected to be effectively addressed.

Option 6

This option is achieving some of the objectives but is contingent upon the adoption of an international agreement in the foreseeable future, and subsequently on the number of participating countries to such agreement. If broad participation could be attained, the effectiveness reducing the financing of armed groups by mineral proceeds in conflict zones is expected to be high. It is not the most timely option given that the problem as described above needs to be handled now.

Comparing the options

The following conclusions can be drawn in relation to the effectiveness of the identified options in achieving the objectives.

Policy option 1, which is a collection of measures outlined in an EU Communication, is among the least effective options in achieving the objectives set. Policy option 2 which is an extension of Option 1 reinforced by a Council Recommendation is on the same level in terms of effectiveness relative to Option 1.

Policy option 3 is assessed as one of the most effective means of achieving the set objectives. Policy option 4 would be equally effective relative to Option 3 but would also generate some possible negative impacts and not address one of the key problems – the market distortion in the Great Lakes Region.

Policy option 5 establishing obligations for EU-listed companies, is assessed equivalent to Options 1 and 2 in terms of effectiveness. Policy option 6 applying an import ban under an international agreement is mid-way in terms of effectiveness between the least effective Options 1, 2 and 5, and most effective 3 and 4. It should be noted that setting up an international agreement requires a lengthy process with an uncertain outcome.

Comparing policy options 3 and 4 in terms of their administrative burden for the targeted importers, most of them SMEs, Option 3 is assessed to be the less burdensome as it affects those companies that

decide choose for self-certification based on their own cost-benefit analysis. Contrary to this, Option 4 imposes requirements on importers. In terms of EU downstream users' ability to respond to clients' due diligence request including US clients, Option 4 is expected to serve better those requests since the mandatory character of the scheme by nature involves a higher number of EU upstream operators relative to the voluntary Option 3. Nevertheless, there is a risk that without addressing the market distortion, most of the extra due diligence thus generated could amount to "greenwashing", with operators meeting corporate social responsibility goals without sourcing in conflict-affected areas.

As far as the potential for delocalisation of EU importers is concerned, we need to refer again to the voluntary nature of Option 3 where this risk has been assessed inferior relative to Option 4.

When comparing Options 3 and 4 in terms of potential impact on EU employment, the assessment points to some possible higher undesired impact of Options 4.

Concerning the expected social impacts on the livelihood of people and the environment in conflict zones, it might be expected that Option 3 delivers the better results relative to Option 4.

The preferred option is Option 3.

Monitoring and Evaluation

Monitoring of implementation will be carried out in cooperation with Member States. In compliance with the principle of subsidiarity, the relevant information should be gathered primarily by Member States. Periodic reporting will be required in order allow for appropriate evaluation of the implementation. The Commission will inform the European Parliament and the Council regularly on the implementation of the new initiative. The Commission should undertake an intermediate evaluation of its new initiative within three years of its adoption assessing the extent to which its results are consistent with the objectives set. The evaluation results will be used for decision-making needs on the future of the policy, and for amendments to the regulatory framework making it mandatory, if appropriate and on the basis of a further impact assessment.