

Dodd-Frank Section 1502: Post-Filing Survey 2014

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Stakeholder Forum

Lawrence Heim

Kristen Sullivan

Fern Abrams

Patricia Jurewicz and Kathleen Brophy

Michael Littenberg

Jessica Lemos

Lina Ramos

- Elm Sustainability Partners
- Deloitte
- IPC
- Responsible Sourcing Network
- Schulte Roth & Zabel
- NAM
- Source Intelligence



Methods

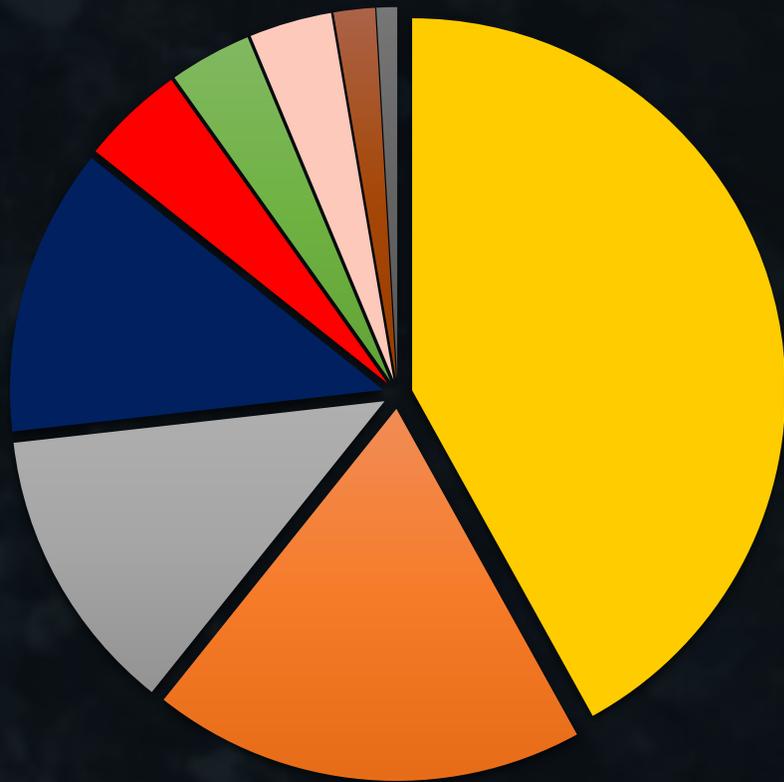
- Cross-sectional study
- *Primary target population*: the 1,300 issuers who filed the Form SD on (and around) June 2, 2014
- *Secondary target population*: Tier 1 suppliers
 - dropped because of low participation
- Representative sample of 112 observations
- Confidence interval of 10% at the 95% confidence level



I. Profile of affected companies



Type of affected companies

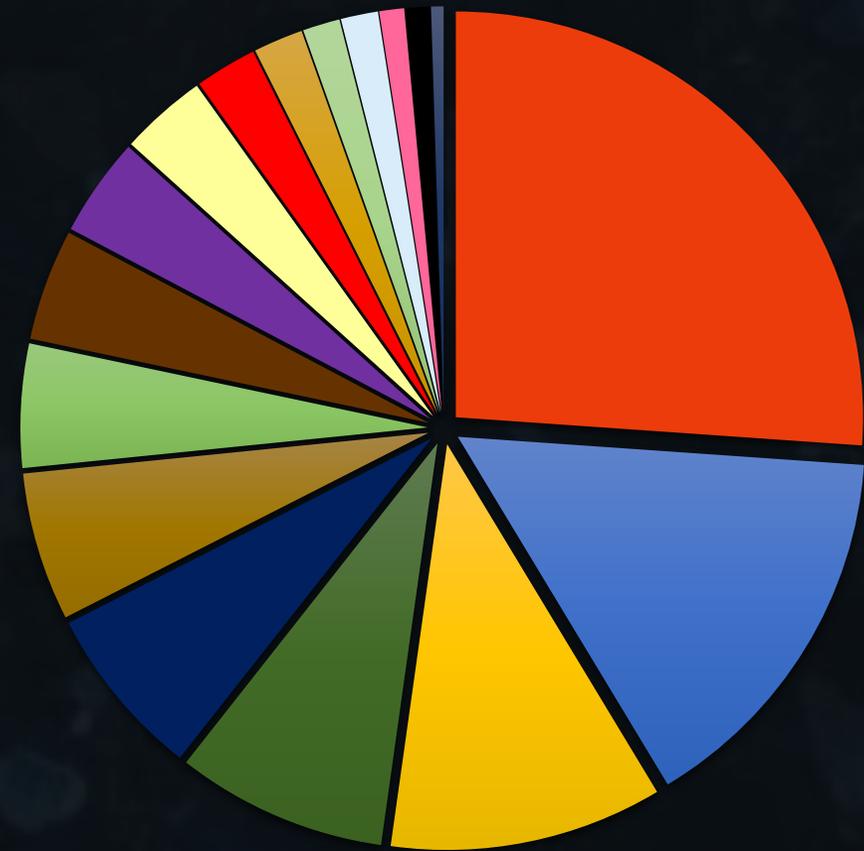


- Original equipment manufacturer, 42%
- Component/sub-assembly manufacturing, 18.8%
- Other manufacturer, 12.5%
- Retail, 12.5%
- Distributor, 4.5%
- Contract manufacturing for other companies, 4%
- Service, 3.6%
- Exploration/ Mining/ Smelting/ Refining, 1.8%
- Processing of smelted/ refined metal (including scrap/ recycled), 1%

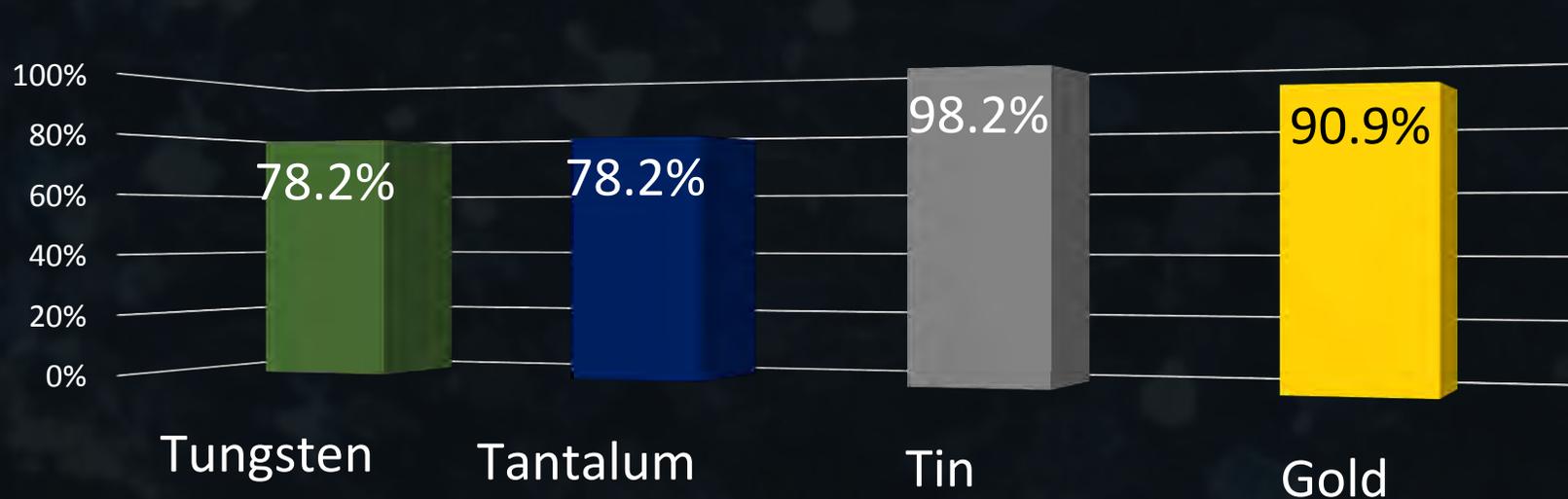


Core Business

- Electric/ Electronics/ High-tech, 26.1%
- Aerospace / Defense, 15.3%
- Medical/ Life Sciences/ Pharmaceuticals, 10.8%
- Automotive/ Truck, 8.4%
- Process & Industrial Products, 6.9%
- Machinery, 5.9%
- Oil & Gas, 4.9%
- Apparel, 4.4%
- Jewelry, 3.9%
- Retail, 3.4%
- Chemical, 2.5%
- Metals, 2%
- Other consumer goods, 1.5%
- Food, 1.5%
- Ag, Construction & Forestry Equipment, 1%
- Sports/ Recreational Equipment, 1%
- Capital Goods, 0.5%



% of Form SD-filing issuers that processed/procured 3TG mineral in 2013



issuers who processed:	%
all four (4) 3TGs	72.7%
three (3) 3TGs	7.2%
two (2) 3TGs	12.7%
one (1) 3TG	7.2%



Amounts of processed/procured 3TG minerals

- The precise amount of 3TG the issuers processed varied greatly
 - The volume of *gold* processed ranged from 100 grams to 4,340 kg
 - *Tungsten* ranged from half a kilogram to 91,597 kg
 - *Tin* ranged from 200 grams to 100,000 kg
 - *Tantalum* ranged from trace amounts to 4,720 kg
- For many issuers, only trace quantities are found in procured subcomponents or components
 - e.g., an office furniture maker had “very little” gold, tungsten and tantalum
 - one retailer had “less than 0.1% (trace amounts only)” of all four (4) 3TGs



Issuer composition and revenue, 2013

- < \$50 million
- \$50 million – \$100 million

\$100 million – \$500 million

\$500 million – \$1 billion

\$1 billion – \$5 billion

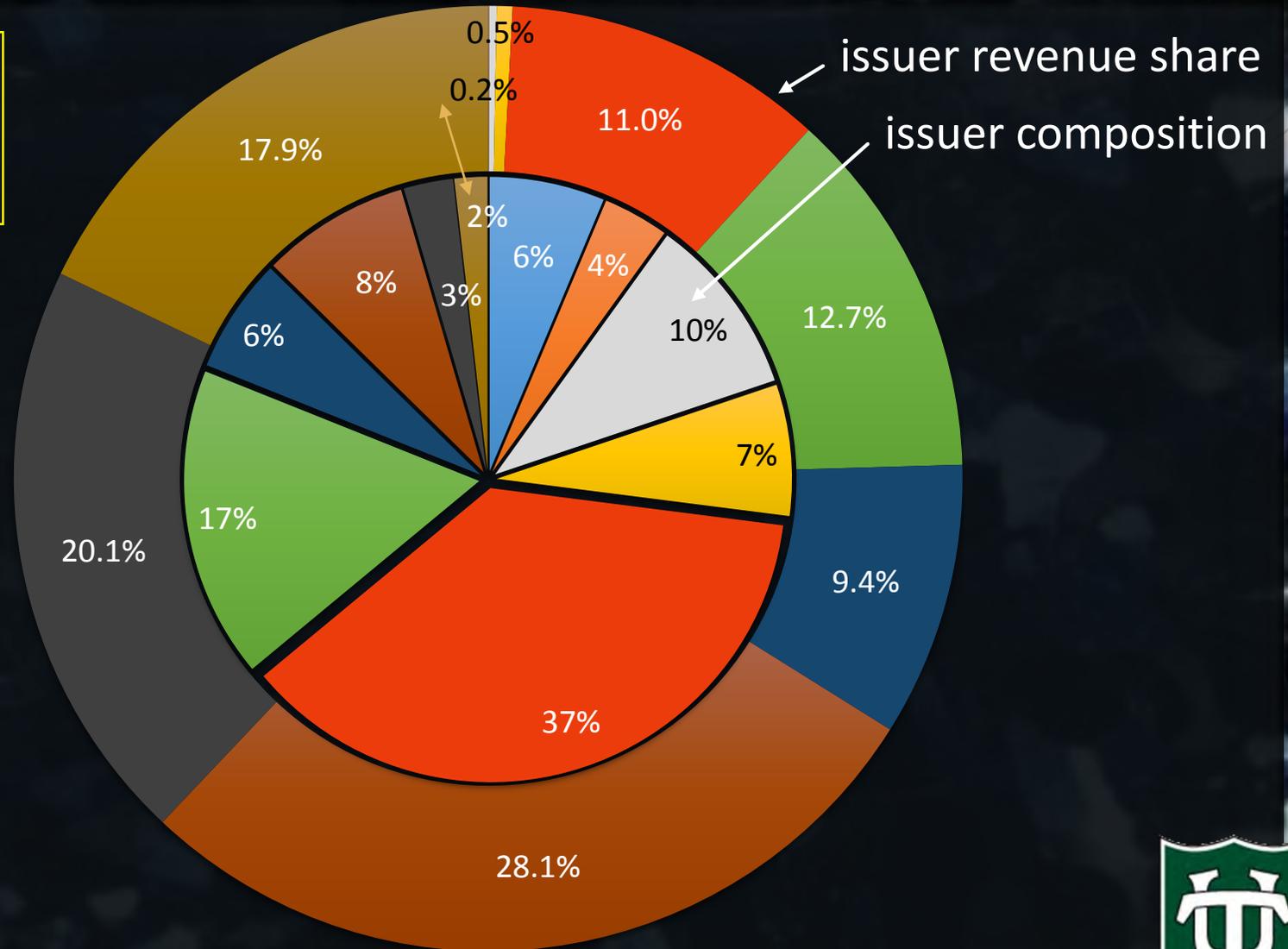
\$5 billion – \$10 billion

\$10 billion – \$20 billion

\$20 billion – \$50 billion

\$50 billion – \$100 billion

> \$100 billion



II. Internal company resources utilized



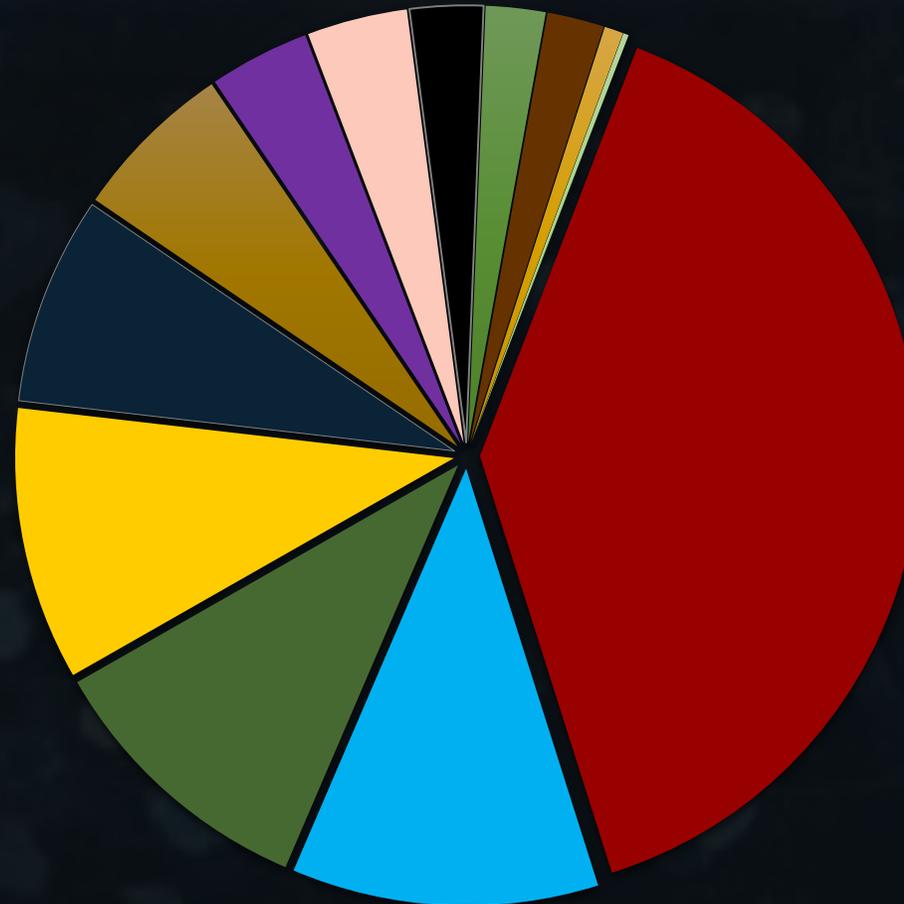
Internal company resources

- 2.7 employees (FTE) on average worked on their company's CMP
- While 33% of these employees were in fact dedicated *full time* to the CMP, 67% were working a *limited LOE* on their CMP



Percent of FTE contributions per job function to CMP

- Supply Chain/ Procurement/ Quality, 39.3%
- Management/ Operations, 11.3%
- Legal, 10.3%
- Senior Company Leaders/ Executives, 10.1%
- Compliance/ Governance, 7.7%
- SEC Reporting/ Finance, 6%
- Internal Audit, 3.7%
- Social Responsibility, 3.7%
- Administrative/ Clerical, 2.7%
- IT / data management service, 2.2%
- EHS, 2.1%
- Engineering, 0.7%
- Investor Relations, 0.2%

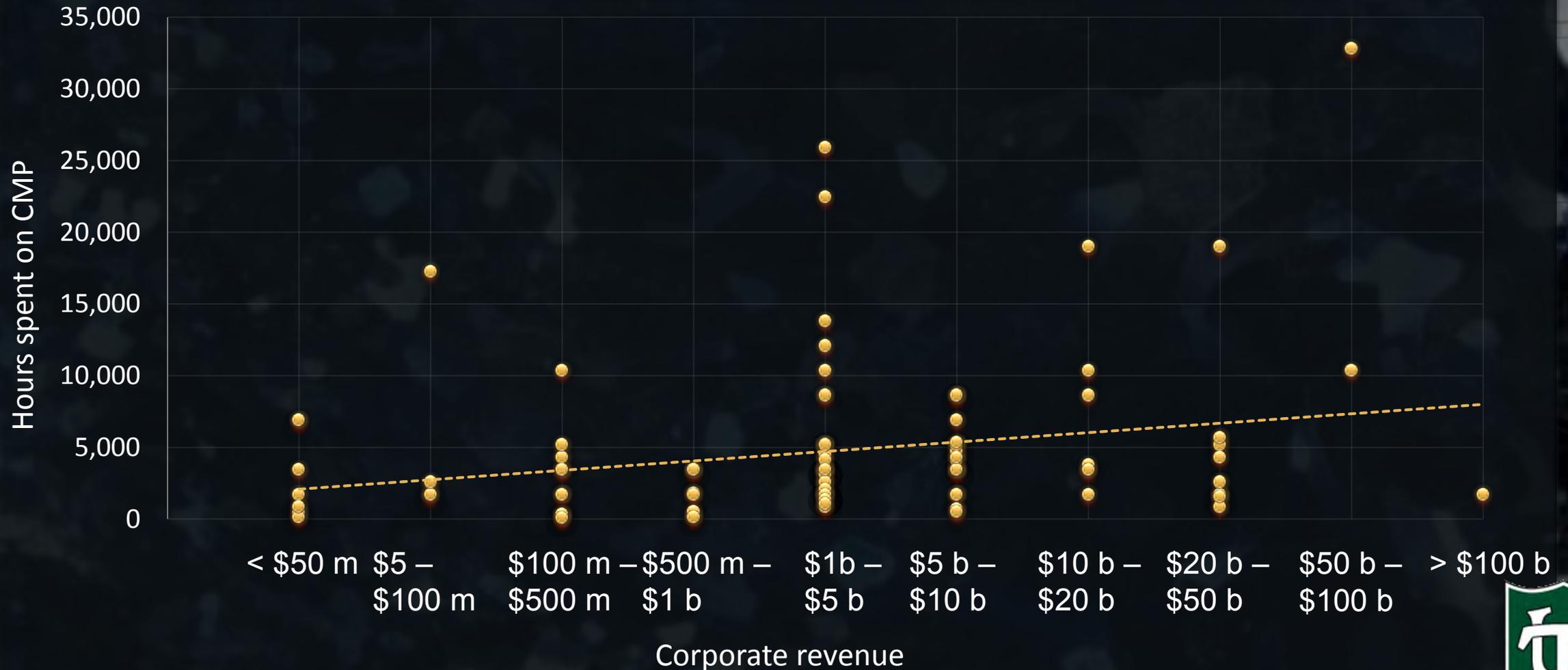


Value of corporate time (A)

- The average value of an employee's labor was **\$66.67** per hour in 2013, ranging from \$20 for an electronics company to \$514 per hour for a biotech company
- Although the final rule was adopted by the SEC on August 22, 2012, companies got going on their conflict mineral programs when U.S. District Judge Wilkins upheld the rule on July 23, 2013
- Between July 23, 2013 and the June 2, 2014 due date of Form SD filing, 216 working days, the affected companies worked a combined 6,139,983 hours on their respective CMPs
- Multiplying the hours they dedicated to their CMP with their respective hourly labor value, yields an aggregate, extrapolated cost of **\$420,784,310**



Company revenue vs. corporate time on CMP

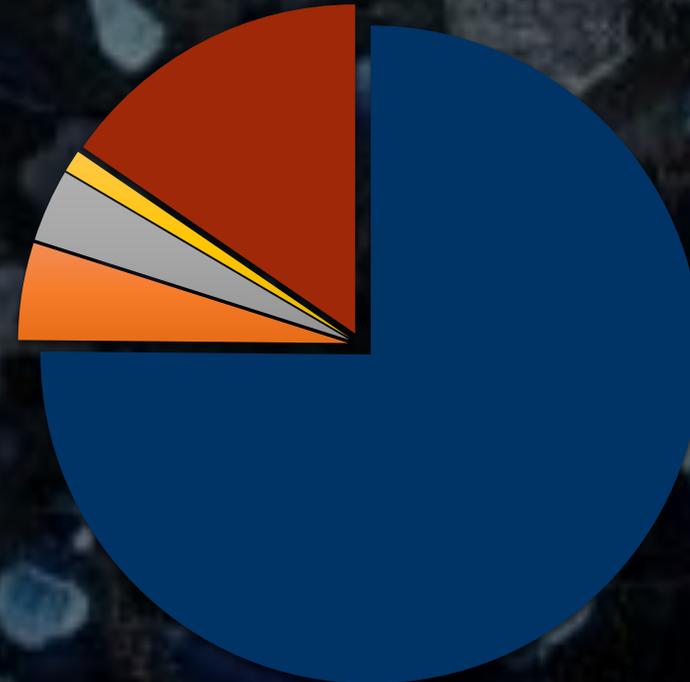


III. External resources utilized



Issuer expenditures on non-IT external resources (B)

- Consultants, 75%
- Auditors, 4.7%
- Industry association costs, 3.5%
- Pilot programs, 1%
- Legal fees, 15.4%

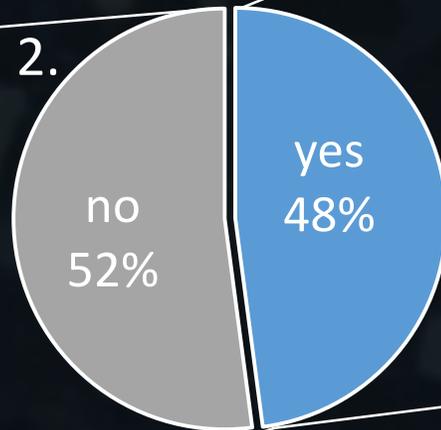
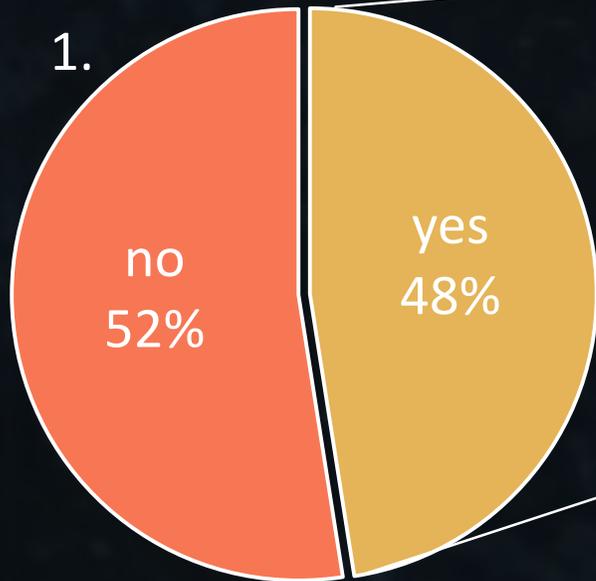


total: \$149,950,495

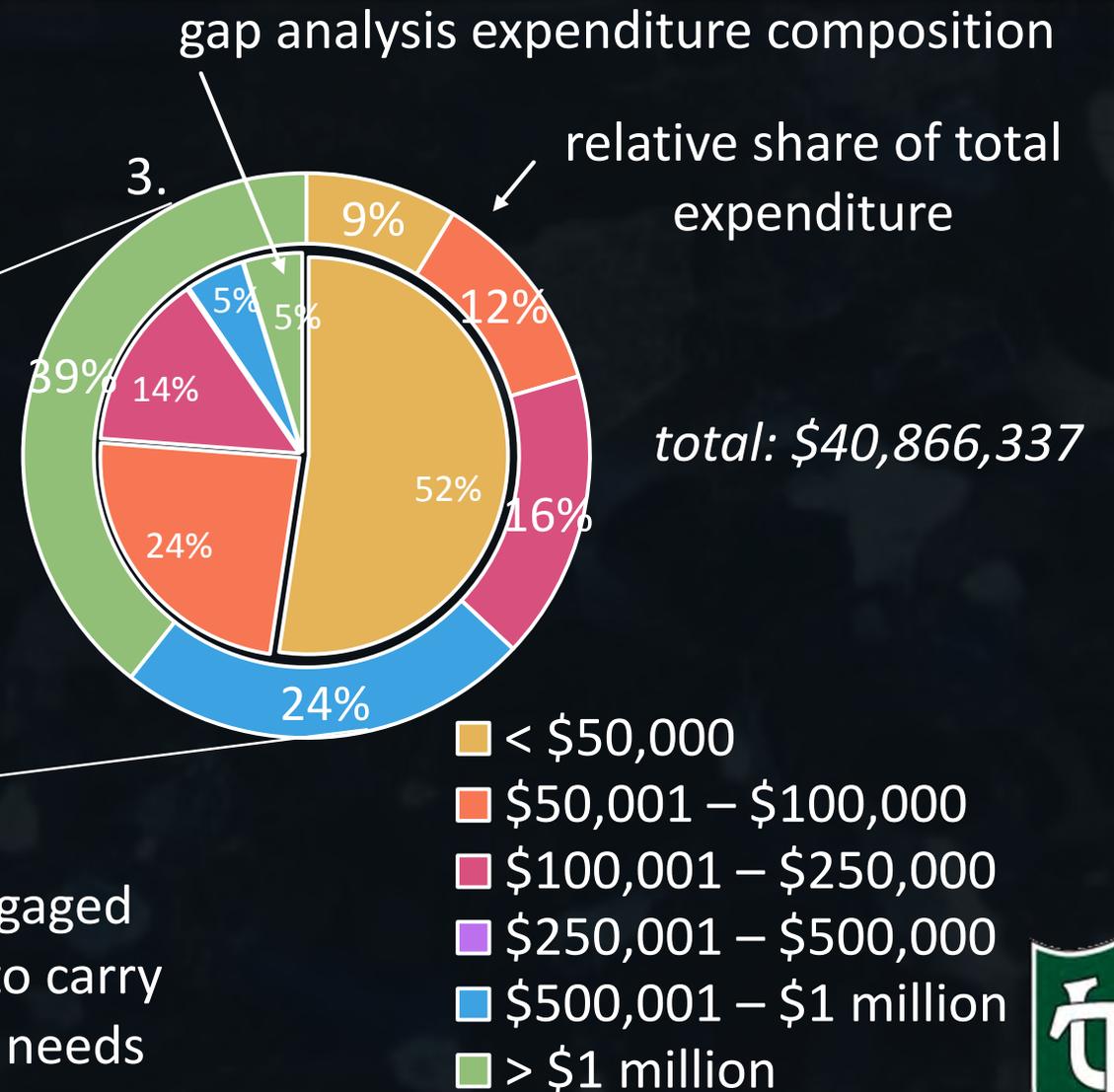


IT system gap analysis and expenditures (C)

% of issuers that conducted a gap/needs analysis for new or modified IT systems to support conflict minerals traceability / and/or reporting

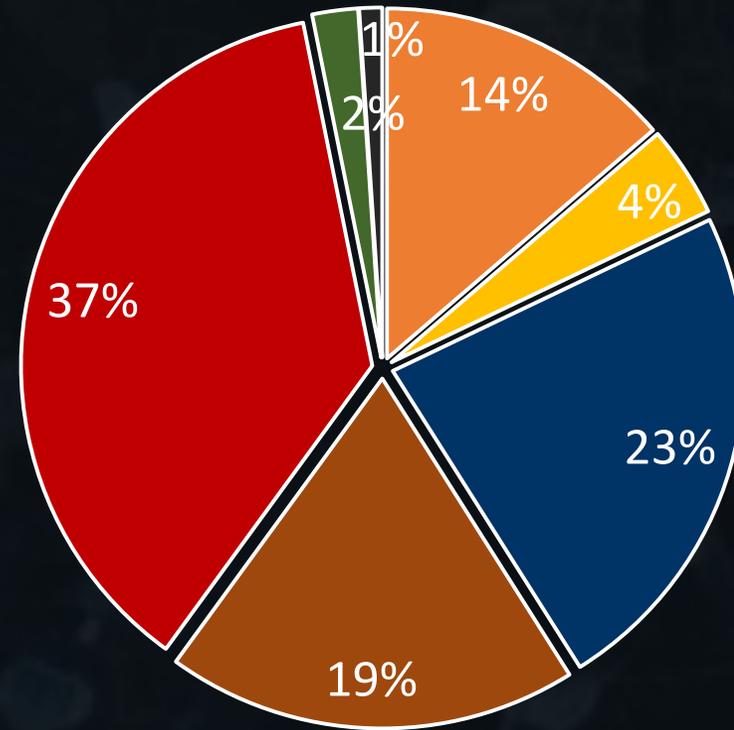


% of issuers that engaged external resources to carry out IT systems gap/needs analysis



IT strategy

- Outsourced: engaged external resources and used/licensed their IT systems/software
- Hired external resources to modify certain existing IT systems/software
- Used internal resources to modify certain existing IT systems/software
- Bought wholly new IT systems/software
- We had no IT system/software needs
- Mix of internal and external resources
- Used internal manpower and open-access resources

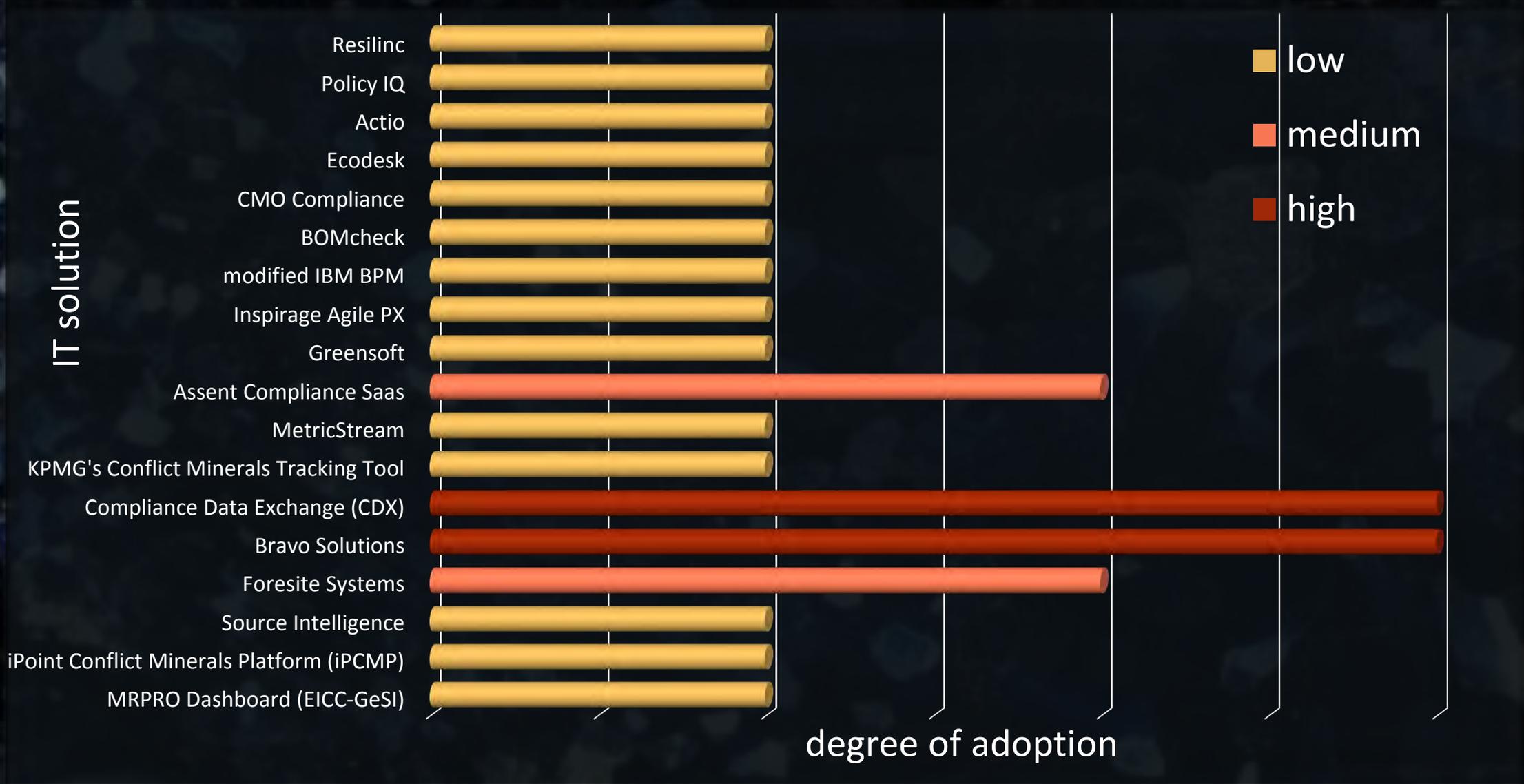


CM templates and DMS

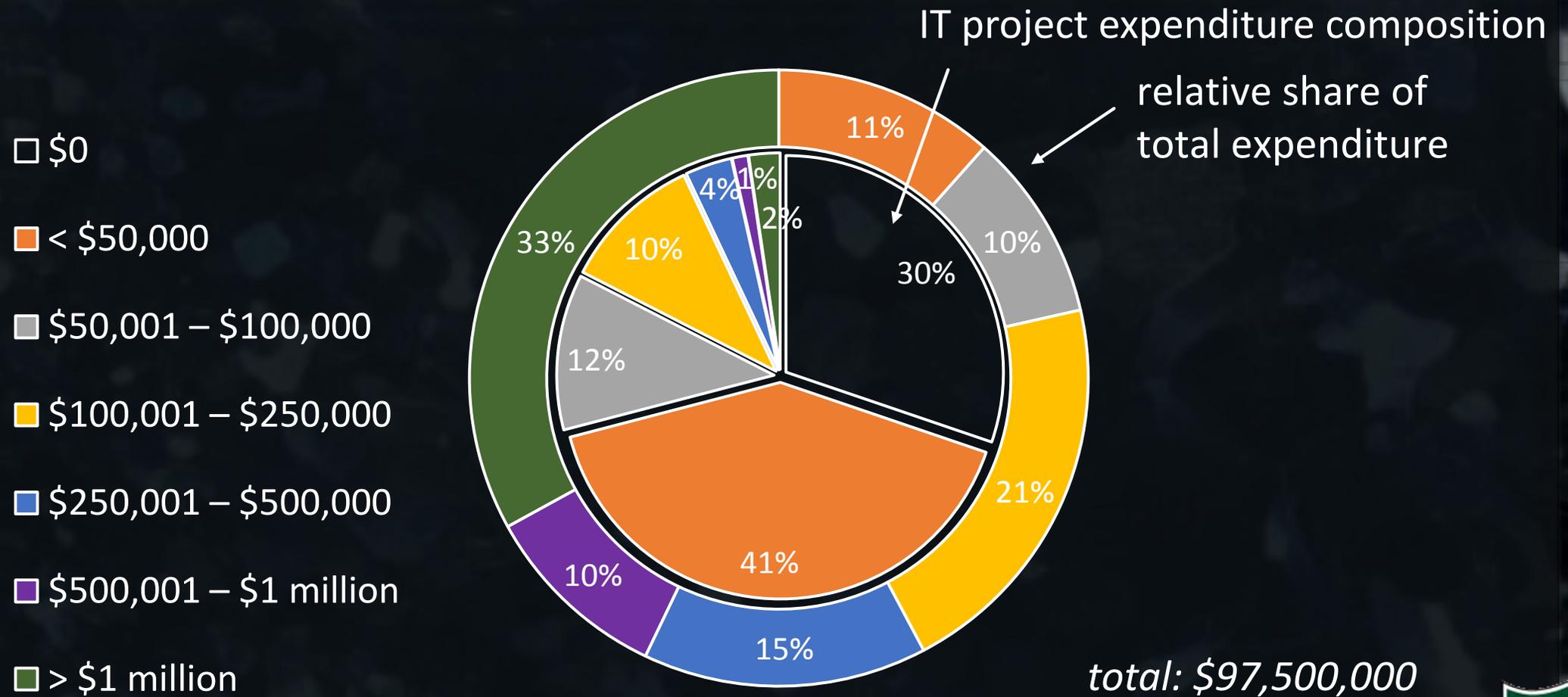
- 90% of issuers used EICC-GeSI's Conflict Minerals Reporting Template (also referred to as the CFSI template) or a modified version thereof
- 37% used a commercially available CM data management system (DMS)



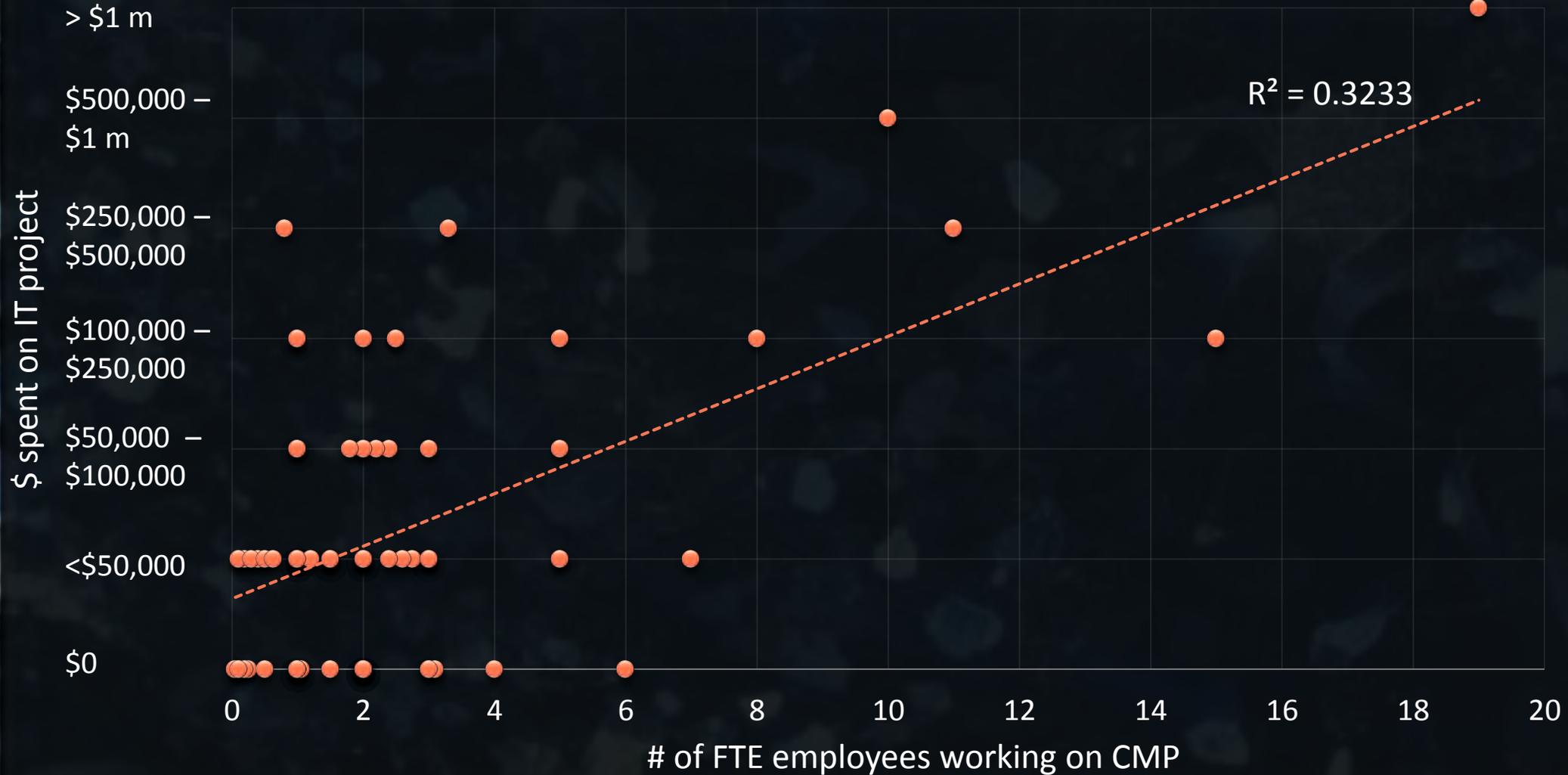
IT platform adoption



CMP-supporting IT project costs (D)



IT project resources vs. # of FTE employees



Conflict minerals report and audit (E)

- 82% of companies filed a Conflict Minerals Report (CMR) in addition to a Form SD
- 1% of companies determined that an Independent Private Sector Audit (IPSA) of the CMR was required for CY2013
- The extrapolated total for the IPSA cost item was \$650,000 for the entire population of issuers in FY2014



IV. Cost summary



Total compliance cost for issuers

- The total aggregated and extrapolated expenses of the 1,300 issuers to comply with Dodd-Frank Section 1502 was \$709.7 million by June 2014
- Thus, on average, an issuer expended \$545,962 to comply with the law

	\$ value	relative share
A. Internal company time	\$420,784,310	59.3%
B. Non-IT related external resources	\$149,950,495	21.1%
C. IT gap / needs analysis	\$40,866,337	5.7%
D. IT project element supporting conflict minerals traceability processes and reporting	\$97,500,000	13.7%
E. Independent Private Sector Audit (IPSA)	\$650,000	0.0009%
<i>total</i>	<i>\$709,751,142</i>	



Compliance cost for small issuers

- A small issuer, with less than \$100 million in revenue, expended resources worth \$190,330 on average – roughly 1/3rd as much as a large issuer counterpart
- In total, compliance cost for small issuers was \$20,429,989



Divination...

	cost to issuers, original estimate (5,994 issuers)	prorated cost to issuers (1,300 issuers)*	accuracy (% of actual)	difference from 100%
<i>before the fact (2011):</i>				
SEC (15 Dec. 2010)	\$71,243,000	\$15,451,435	2%	- 98%
NAM (2 Mar. 2011)	\$8,000,000,000	\$1,735,068,402	244%	+ 144%
Tulane (17 Oct. 2011)	\$2,796,048,360	\$606,416,895	85%	- 15%
Claigan (16 Dec. 2011)	\$387,650,000	\$84,074,908	12%	- 88%
SEC (22 Aug. 2012, low end)	\$3,000,000,000	\$650,650,651	92%	- 8%
<i>after the fact (2014):</i>				
actual (this study)		\$709,751,142	100%	0%

* prorated at 21.69% of original SEC issuer projection



Relative CPM cost vs revenue

- The cost of the CMP ranged from 0.0000006% to 0.048% of the respective company's 2013 revenue, with a mean of 0.00125% (standard deviation of 0.0053)
- Small companies (8.26% with revenue under \$100 million) were slightly more affected with a cost of 0.007% of their revenue



V. Synergies



Support for supply-chain / in-region initiatives

<i>Support, through purchasing requirements or membership, for:</i>	<i>%</i>
Solutions for Hope (SfH) closed pipe system	2%
ITRI Tin Supply Chain Initiative (iTSCi)	4%
ICGLR Certification	1%
BGR Certified Trading Chains	1%
Conflict Free Tin Initiative	6%
KEMET Partnership for Social and Economic Stability	3%
LBMA Good Delivery	2%
RJC Chain of Custody Certification	3%
Conflict Free Sourcing Initiative (CFSI) of EICC-GeSI	59%
Public-Private Alliance for / Responsible Minerals Trade (PPA)	4%



P2P engagement

<i>Engagement with peers and stakeholders on:</i>	<i>%</i>
supplier matters (code of conduct, sourcing, mineral content, reporting, and other processes)	72%
compliance, internal process matters	44%
supply chain traceability	44%
matters of international diplomacy	4%
conflict mineral policy	79%



VI. Market impact



		<i>Agree</i>	<i>Neither agree nor disagree</i>	<i>Disagree</i>
1.	DF S1502 has leveled the playing field, among U.S. publicly listed companies, with regard to sourcing minerals from the DRC and neighboring countries.	9%	36%	55%
2.	Due to DF S1502–related actions, we have identified opportunities for consolidation (vertical integration) and supply chain cost reduction.	1%	18%	81%
3.	Due to DF S1502–related actions, we have improved our risk management (e.g., pre-emptive identification of risk such as reliance on sole-sourced suppliers).	18%	25%	57%
4.	Due to DF S1502–related actions, we have improved our supply chain performance management in terms of responsiveness and efficiency.	11%	17%	72%
5.	Due to DF S1502–related actions, we have initiated a process with which to respond to customer requests for CM-related information.	71%	16%	13%
6.	Due to DF S1502–related actions, we have improved our ability to respond to customer requests for CM-related information.	78%	16%	7%
7.	Due to DF S1502–related actions, we now have data and standards with which to conduct future supplier certification.	41%	26%	33%
8.	Due to DF S1502–related actions, we now have improved supplier policies.	30%	32%	38%



		<i>Agree</i>	<i>Neither agree nor disagree</i>	<i>Disagree</i>
9.	Due to DF S1502–related actions, we now have processes in place to improve our confidence in our responsible sourcing practices, specifically with respect to the DRC and surrounding countries.	43%	36%	21%
10.	Due to DF S1502–related actions, the increased information transparency between suppliers and customers throughout the supply chain has led to greater overall market efficiency.	4%	30%	66%
11.	We foresee that 3TG suppliers who supply complete and accurate Reasonable Country of Origin Inquiry (RCOI) information on a timely basis will be awarded more business in the future.	21%	43%	36%
12.	Due to post-DF S1502–related activity, there is significantly more interaction with other companies in a collaborative manner.	22%	34%	44%
13.	We foresee that 3TG-consuming/processing companies who do not comply with their customer’s (higher tiered company) conflict minerals policy be penalized up to seeing their contract terminated.	39%	42%	19%
14.	Due to DF S1502-requirements, we are avoiding procuring/using 3TG materials from the covered countries.	24%	38%	38%



		<i>Agree</i>	<i>Neither agree nor disagree</i>	<i>Disagree</i>
15.a.	Due to DF S1502-requirements, issuers who (purposefully) use conflict-free minerals from the DRC and region now have higher SEC reporting costs.	38%	45%	17%
15.b.	- If agree, approximately how much higher?	range: \$5,000 – \$1 m average: \$268,750		
	- Cost drivers mentioned:	<ul style="list-style-type: none"> • direct tracing and supplier engagement • consumer reporting • cost of an (IPSA) audit • brand reputation damage due to poor media coverage understanding of terminology and process 		

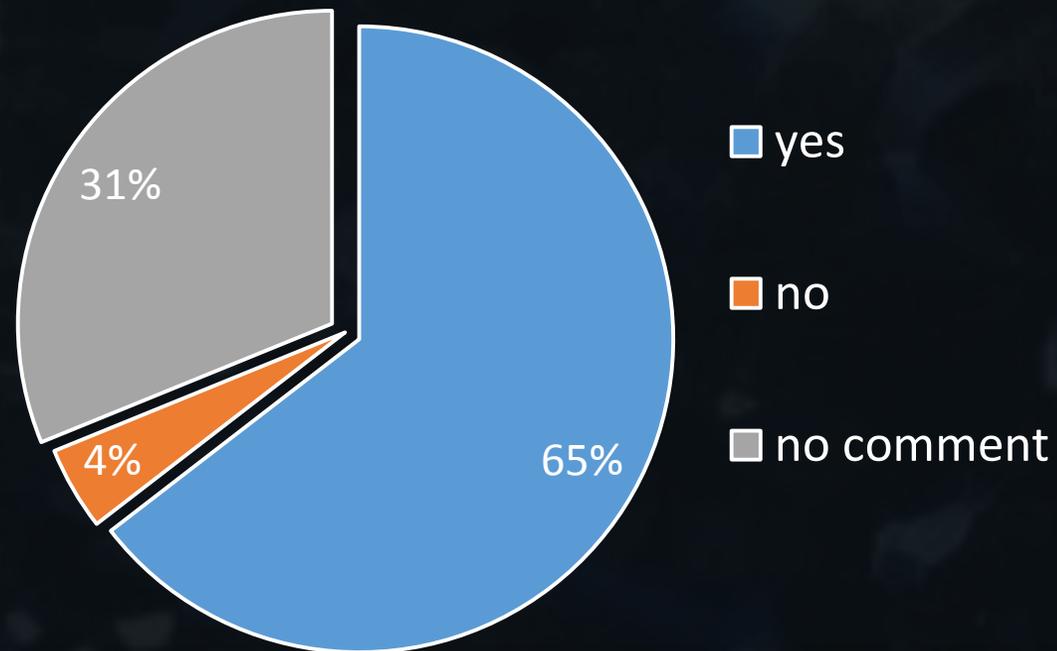


		<i>Agree</i>	<i>Neither agree nor disagree</i>	<i>Disagree</i>
16.	Enhanced B2B transparency, as required to achieve DF S1502, promotes accountability between suppliers and customers within the industry.	33%	47%	20%
17.	Due to the increased transparency of information required to achieve compliance with DF S1502, downstream companies now have more choices and/or market control compared to upstream companies.	8%	55%	37%
18.	An increasing adoption of 3TG IT platforms lowers the cost of information acquisition.	19%	43%	38%
19.	Due to DF S1502–related actions, our Corporate Social Responsibility standing has improved.	20%	42%	38%
20.	In general, we are witnessing an increased customer/consumer demand for conflict-free products.	28%	22%	50%



Perception of law

“Would your company like to see any modification to either Dodd-Frank Section 1502 or the SEC rule?”



Issuer's chief reservations about D-F S1502

frequency of mention

The law renders affected companies less competitive due to the heavy cost burden

It is unlikely the desired impact is being achieved in the DRC

The law is unfair in that it is trying to fight a war in the business world with only public companies

The SEC not intended as a regulator of social responsibility



Issuer recommendations

frequency of mention

- repeal
- stipulate a *de minimis* exemption
- clarify rule
- focus on importation of 3TG
- render disclosure voluntary
- offer supply chain degree threshold exemption
- extend indeterminable period
- provide information on and certify SORs
- align with the EU proposed legislation
- promote standard process and systems across industry
- remove audit requirements
- expand scope to include diamonds
- remove mandatory disclosure



Rule clarification

Related to “necessary to the functionality and production” of goods:

- confirm that polymers including Tin compounds are out of scope
- clarify that rule is limited only to direct metals from the ores
- clarify the "derivatives" issue

Related to reasonable country of origin inquiry (RCOI):

- more guidance on RCOI conduct



VII. Good practices



Good practices

- 3TG identification
- CMP conceptualization
- risk assessment
- internal streamlining
- supplier engagement & communication
- collaboration / standardization with trade associations & peers



Thank you for your interest!

(stay tuned for a more in-depth paper on this subject)

Competing interests

The author, Chris N. Bayer, declares that he has no competing interests, and does not have a position in stocks or funds affected by the law/rule in question.