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SEC Final Rule on the Conflict Minerals Section 1502 of the Dodd-Frank Act

A review of the final rule and changes to the original proposal

SEC Final Rule on Conflict Minerals
Section 1502 of Dodd-Frank

This presentation is intended to be a high level overview of the SEC Final Rule and guidance to the Conflict Minerals Section 1502 of the Dodd Frank Wall Street Reform and Consumer Protection Act (Pub.L. 111-203, H.R. 4173), which was issued on August 22, 2012.

Section 1502's objective is to prevent the exploitation and trade of tin, tantalum, tungsten and gold by armed groups to finance conflict characterized by extreme levels of violence in the Democratic Republic of the Congo and adjoining countries.

SEC Final Rule on Conflict Minerals
Section 1502 of Dodd-Frank

This review is not intended as a comprehensive treatise, nor should it be treated as such.

Some comments in this presentation represent the opinion of the author and should be accepted as such.

The final SEC Rule can be found here:
http://www.sec.gov/rules/final/2012/34-67716.pdf
The entire Dodd-Frank document can be found here:
http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf

SEC Final Rule on Conflict Minerals
Section 1502 of Dodd-Frank

- On August 22, 2012, by a 3-2 vote, the SEC issued a final rule requiring issuers to disclose their use of “conflict minerals” and whether those minerals originated from the Democratic Republic of the Congo and neighboring countries.

- An issuer (domestic or foreign) is subject to the rule if (1) it files Exchange Act reports with the SEC and (2) conflict minerals are “necessary to the functionality or production of a product” that it either manufactures or contracts to be manufactured.

- A reasonable “country of origin” inquiry must be performed to determine if the minerals originated in the covered countries or from scrap or recycled sources

SEC Final Rule on Conflict Minerals
Section 1502 of Dodd-Frank

- Issuers must exercise due diligence on the source and chain of custody of their conflict minerals.

- This due diligence must conform to a nationally or internationally recognized due diligence framework such as the due diligence guidance issued by the Organization for Economic and Cooperative Development (OECD)

- The first reporting period is calendar year 2013 with the first report due by May 31, 2014.

SEC Final Rule on Conflict Minerals
Section 1502 of Dodd-Frank

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Exclusions

- In a departure from the original proposal, excluded are:
  (1) issuers that mine conflict minerals but don't manufacture anything, and
  (2) conflict minerals that have been smelted or refined before January 31, 2013.

- This second exclusion above addresses the concerns regarding current stockpiles of conflict minerals that were mined prior to the Rule, and as such, grandfathers these stockpiles for a very specific period; therefore allowing everyone to look forward rather than backward.

SEC Final Rule on Conflict Minerals
Section 1502 of Dodd-Frank

Necessary to the **functionality** or production

- Regarding “necessary to the **functionality** of the product”, the rule eliminates the reporting of conflict minerals that are contained in but unintentionally added to products, e.g.:
  - Trace or natural occurring by-products

- Another consideration is whether the mineral is necessary to the product’s generally expected function, use or purpose, e.g.:
  - When the primary purpose of a product containing a conflict minerals is ornamental or for decoration and the conflict mineral is unrelated to the products purpose a report is not required. A report is not required for the converse situation.

SEC Final Rule on Conflict Minerals
Section 1502 of Dodd-Frank

Necessary to the functionality or **production**

- Regarding “necessary to the **production** of the product”, the issuer should consider whether the mineral is intentionally added in the production process or necessary to produce the product. In a change from the original proposal, the minerals must be contained in the final product, e.g.:
  - Reporting is not required when a conflict minerals is present in a catalyst used in the production of the product.
  - Using the same logic, a machine tool made of a conflict mineral may be necessary to the production of the product; however, as the conflict mineral is not contained in the final article it would not require reporting.

SEC Final Rule on Conflict Minerals
Section 1502 of Dodd-Frank

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Contracting to manufacture

- If the issuer has some influence over the manufacturing of a product, an issuer is considered to be “contracting to manufacture”;

- In a change to the proposed rule, a company is not deemed to have influence over the manufacturing if it only:
  - Attaches its brand or logo to a generic product manufactured by a third party (e.g.: private label).
  - 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.

SEC Final Rule on Conflict Minerals
Section 1502 of Dodd-Frank

- Recycled or Scrap – if a company's conflict minerals are determined to be derived from recycled or scrap sources, products containing such minerals are considered "DRC Conflict Free".

- Issuers with gold from recycled or scrap sources, however, are required to submit a specialized disclosure report for that mineral using the OECD's due diligence for recycled or scrap gold.

- Report issuers will be required to provide disclosure on the new Form SD. Calendar year reporting must be completed by May 31 of the following year.

SEC Final Rule on Conflict Minerals
Section 1502 of Dodd-Frank

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Conflict Minerals Report

- Must be “filed”
- The issuer’s CEO and CFO are not required to certify the disclosure (Form SD).
- The Conflict Minerals Report must be posted on the issuer’s website for a period of one year.
- An issuer that acquires or obtains control over a company that manufactures/ contracts to manufacture products containing conflict minerals may delay the initial reporting period on the products of the acquired company until the first calendar year beginning no sooner than eight months after the effective date of the acquisition.

SEC Final Rule on Conflict Minerals
Section 1502 of Dodd-Frank

- Originally the conflict minerals cited in the report must fall into one of the following designations:
  - DRC Conflict Free
  - Not DRC Conflict Free
  - DRC Conflict Undeterminable (available for 2 or 4 years based on company size)

- In 2012 the National Association of Manufacturers, the U.S Chamber of Commerce and the Business Roundtable filed suit challenging the SEC reporting rules.

- In April 2014 U.S. Appeals Court finds the conflict minerals rule violates free speech.

SEC Final Rule on Conflict Minerals
Section 1502 of Dodd-Frank

- In April 2014 the SEC issues guidance in response to court ruling stating no company is required to describe its products as “DRC conflict free,” having “not been found to be ‘DRC conflict free,’” or “DRC conflict undeterminable.” If a company voluntarily elects to describe any of its products as “DRC conflict free” in its Conflict Minerals Report, it would be permitted to do so provided it had obtained an independent private sector audit (IPSA) as required by the rule.

- In April 2017 the Court issues final judgement that requiring companies to state on their website products “not been found to be DRC Conflict Free” violates First Amendment.

SEC Final Rule on Conflict Minerals
Section 1502 of Dodd-Frank

- Following April 2017 court ruling SEC issues following responses:

- SEC Division of Corporate Finance

  "will not recommend enforcement action to the Commission if companies, including those that are subject to paragraph (c) of Item 1.01 of Form SD, only file disclosure under the provisions of paragraphs (a) and (b) of Item 1.01 of Form SD."

  (Paragraph (c) is the due diligence requirement including CMR and IPSA)

- SEC Acting Chairman Piowar

  "In light of the foregoing regulatory uncertainties, until these issues are resolved, it is difficult to conceive of a circumstance that would counsel in favor of enforcing Item 1.01(c) of Form SD."

SEC Final Rule on Conflict Minerals
Section 1502 of Dodd-Frank

- Despite the court ruling and SEC comments companies continue reporting on their due diligence efforts.

Why it's worth the effort