Principles for Responsible Investment

DRILLING DOWN INTO THE COBALT SUPPLY CHAIN:

HOW INVESTORS CAN PROMOTE RESPONSIBLE SOURCING PRACTICES

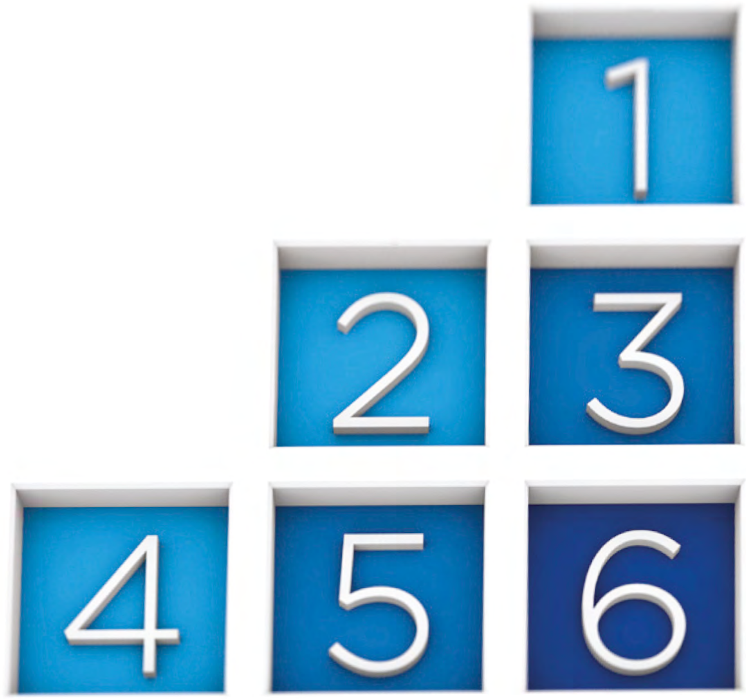
An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

THE SIX PRINCIPLES

PREAMBLE TO THE PRINCIPLES

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1. **We will incorporate ESG issues into investment analysis and decision-making processes.**
2. **We will be active owners and incorporate ESG issues into our ownership policies and practices.**
3. **We will seek appropriate disclosure on ESG issues by the entities in which we invest.**
4. **We will promote acceptance and implementation of the Principles within the investment industry.**
5. **We will work together to enhance our effectiveness in implementing the Principles.**
6. **We will each report on our activities and progress towards implementing the Principles.**



PRI's MISSION

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

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Cover image: reproduced courtesy of the Washington Post microsite The cobalt pipeline. Story by Todd C. Frankel, photo by Michael Robinson Chavez (published 30 September 2016).

HUMAN RIGHTS RISKS IN THE COBALT SUPPLY CHAIN

Lithium-ion batteries power products at the cutting edge of technology, from smartphones to laptops and electric cars. But while they are often considered to be greener than their lead-acid counterparts, the major electronics and automotive companies that use them can expose themselves to serious risks.

That's because not only is the cobalt used in the batteries that power these devices obtained via a lengthy and complex supply chain, but cobalt mining has a high human toll. While it is not a conflict mineral, as it is produced in the relatively peaceful southern province of Katanga, the DRC is a high-risk area, where up to 20% of the country's cobalt is extracted by artisanal miners. Serious, systemic human rights violations are commonplace, including child labour, exposure to health hazards from high levels of toxic metals, and lack of the most basic safety equipment inside and around the mines. The growing demand for the mineral is also fuelling an increase in price that could have disruptive effects on local communities.

WHY SHOULD INVESTORS PAY ATTENTION TO COBALT?

The investment community increasingly recognises that it has a key role to play in pushing for the adoption of more responsible cobalt sourcing practices. In addition, under the OECD Guidelines for Multinational Enterprises[1], institutional investors are expected to behave responsibly and determine their exposure to human rights risk within their portfolios and conduct due diligence to prevent or address adverse impacts.

Human rights violations and child labour in the cobalt supply chain could expose companies and investors to material reputational, operational and regulatory risks. This includes severe brand damage and impact to company share value; a negative impact on operations and production capacity; and potential strikes and disruptions. And while there isn't any binding regulation around cobalt yet, given the regulatory developments around conflict minerals, it is likely that policymakers, particularly in the EU, will fill this regulatory gap.

Human rights violations in the cobalt supply chain could lead to severe brand damage, negative impact on operations and strikes and disruptions

Cobalt is most often sourced from the Democratic Republic of the Congo (DRC), which is home to more than half of the world's cobalt resource. Demand for the mineral is expected to continue growing in coming years.

ABOUT THIS BRIEF

Following the release of Amnesty International's report, This is what we die for, 23 institutional investors started engaging with 13 companies from the electronics and automotive sectors on their cobalt sourcing practices.

The companies' responses to engagement varied greatly. Some of the more advanced ones had started to treat cobalt as a conflict mineral and begun to carry out the same due diligence efforts they did with tin, tantalum, tungsten and gold (the 3TGs). Although their processes were still in their infancy, it showed a willingness to tackle the issue. Other companies provided disappointing responses to the investors' request for information, claiming to rely on cobalt not sourced from the DRC. Given the amount of cobalt used in the companies' products, not only were these claims very unlikely, but they also failed to provide proof to back them up.

1 OECD, Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises, 2017, https://mneguidelines.oecd.org/RBC-for-Institutional-Investors.pdf

The groups of investors therefore decided to create a set of questions which would allow for a like-for-like comparison of progress between companies. The PRI agreed to undertake research and hold dialogues with the relevant stakeholders to flesh out the original asks of the group to companies.

The investor expectations and recommendations in this brief are the outcome of this research and can be used by investors engaging companies on their cobalt sourcing practices. Although this brief mainly focuses on child labour risks in the cobalt supply chain, it aims to encourage companies and entities along the supply chain to build strong due diligence and risk assessment mechanisms so they have the right systems in place to gradually focus on every material human rights risk area.

INVESTOR EXPECTATIONS AND ENGAGEMENT

Investor expectations towards companies with regards to the responsible sourcing of cobalt centre on three main areas:

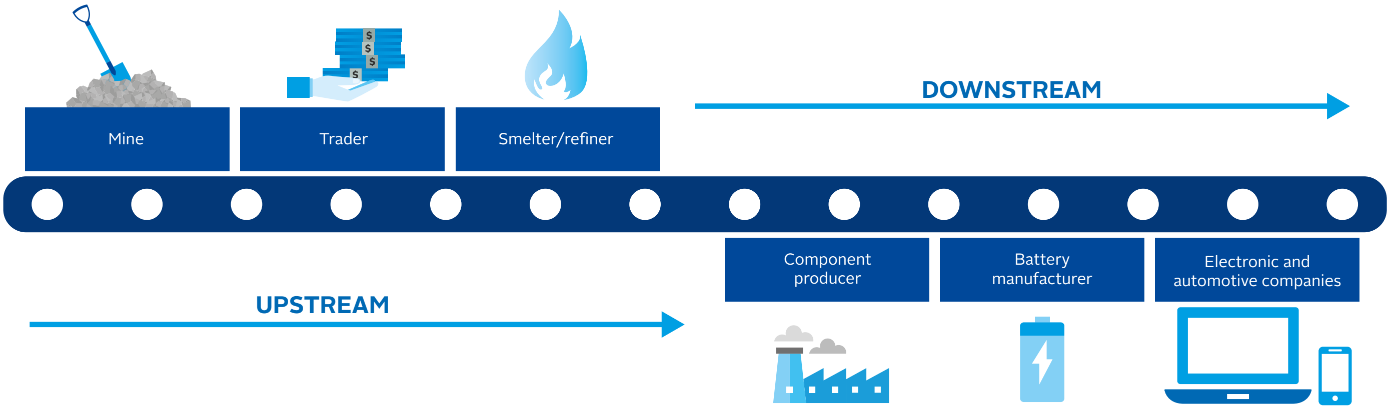
- human rights risk assessments and comprehensive due diligence efforts;
- provision of remedy;
- participation in collective initiatives.

Investors expect greater disclosure from companies around:

- their commitment to responsible sourcing of cobalt and how they plan to do it;
- and prioritisation of risk mitigation over risk avoidance.

Investors are also concerned that companies have stopped or have considered stopping sourcing from artisanal and small-scale mines (ASM) permanently as doing so may have negative effects on the livelihood of local communities.

THE RISKS IN THE UPSTREAM COBALT SUPPLY CHAIN



ASM: Carried out informally by individuals or communities using manual labour and hand tools. 20% of the cobalt sourced from the DRC is mined this way.

Large-scale mining (LSM): Industrial mining that represents 80% of the cobalt sourced from the DRC.

LSM and ASM supplies can sometimes become intertwined as traders may sell ASM-produced cobalt to medium-size industrial mining companies to top up their own production. Despite this, each have their own unique risks:

LSM-related risks:

- Miners and local communities are often exposed to high levels of toxic metals – medical studies have shown the link between the presence of mines with birth defects and other health hazards.[2]
- Poor occupational health and safety conditions such as inadequate protective equipment.
- Poor community relations e.g. reports of forced evictions around the mines.[3]
- Potential for human rights violations by private/public security personnel when preventing ASM miners from going into LSM sites.

ASM-related risks:

- Child labour: in 2012, UNICEF estimated that 40,000 children worked in the country's south mining industry.[4] Since then, and despite the DRC government's commitment to eradicate child labour, reports do not indicate that this number has gone down.
- Working conditions: lack of oversight from relevant authorities means that the tunnels mined by artisanal miners often exceed the 30-metre depth limit; no health and safety standards are respected, exposing the miners to injuries, deadly accidents and health hazards, given their prolonged exposure to dangerous metals.
- Unfair compensation of miners (with traders relying on asymmetry of information).
- Legality of mining (with lack of formalised/regulated artisanal mining areas): regulated ASM operations are in the minority – many ASM mines are dug and operated illegally and without oversight, sometimes on larger LSM concessions.

2 High human exposure to cobalt and other metals in Katanga, a mining area of the Democratic Republic of Congo, Banza C. et al., 2009, https://www.ncbi.nlm.nih.gov/pubmed/19486963

3 Cobalt blues, environmental pollution and human rights violations in Katanga's copper and cobalt mines, Scheele F. et al., April 2016, https://www.somo.nl/nl/wp-content/uploads/sites/2/2016/04/Cobalt-blues.pdf

4 IN DR Congo, UNICEF supports efforts to help child labourers return to school, UNICEF website, https://www.unicef.org/childsurvival/drcongo_62627.html

HOW HAVE COMPANIES BEEN ADDRESSING HUMAN RIGHTS RISKS?

CONSUMER ELECTRONICS

Apple has mapped its supply chain down to the mines and formed a coalition of industry players that led to the creation of a risk readiness assessment tool. One hundred percent of smelters in the chain receive third-party audits and Apple works closely with suppliers and miners to build capacity and improve practices.

AUTOMOTIVE

BMW has published the list of smelters/refiners its suppliers work with and the countries of origin of the cobalt they use. The group is currently focusing on developing an audit standard as part of the standardisation of the internal processes for conflict minerals and cobalt.

BATTERY MANUFACTURERS

Samsung SDI has put pressure on large miners to demonstrate that third-party audit assessments are conducted, rather than having them rely on their own corporate audits. The company has also gained greater control over its supply chain by consolidating it from five tiers to one.

SMELTER

Huayou Cobalt has consolidated its cobalt sources to two main mines to ensure they are child labour free. While this is a positive development, it may simply be moving the problem onto Huayou's competitors, as they continue to source from smaller/problematic mines[5].

5 The company has made attempts to manage risks at ASM mines from which it sources cobalt through two approaches: ring-fence sourcing from mines that are in residential areas and closed loop sourcing systems from sites on former LSM concessions that have been ceded to ASM cooperatives. The cobalt sourced from this second type of mine is sold to a single trader, sealed and sent directly to its fully-owned Congolese subsidiary, CDM. This reduces both the number of links in the chain and the company's risk exposure, as it enhances its capability to conduct the due diligence with a single identified trader.

HUMAN RIGHTS RISK ASSESSMENT AND DUE DILIGENCE – DOWNSTREAM

The OECD Guidance for Multinational Companies sets out different due diligence requirements that stem from the different responsibilities companies have according to their location in the supply chain.

EXPECTATIONS FOR DOWNSTREAM COMPANIES

- Have a clear responsible sourcing policy in place that specifically includes cobalt – senior oversight, accountability mechanisms and systems to measure the effectiveness of the policy along with an explicit timeline for implementation.
- Identify smelters or refiners in their supply chain and assess whether they conduct due diligence in compliance with international standards – should this not be the case, downstream companies must use leverage to pressure suppliers into taking the necessary steps.
- Report at least annually on targets and progress in reaching them as well as reporting on both the socio-economic (and expected) outcomes of actions by the company.

KEY QUESTIONS FOR DOWNSTREAM COMPANIES

RESPONSIBLE SOURCING POLICY AND GOVERNANCE

- Does the company have a responsible sourcing policy or equivalent for minerals, specifically cobalt, and is it aligned with relevant aspects of the OECD's Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, the UN Guiding Principles on Business and Human Rights and the International Labour Organization (ILO) standards?
- How has the company gone about implementing this policy and how is this communicated to and embedded in the relevant units/divisions of the company?
- Has the company set some clear targets around this policy? What is the time horizon of these targets? Are there some internal accountability mechanisms should the targets be missed?

TRACEABILITY AND HUMAN RIGHTS RISK ASSESSMENT

- Does the company provide evidence to demonstrate that it appreciates the length and complexity of its cobalt supply chain?
- Has the company mapped its supply chain at least down to the smelter level and ideally down to mine level? Has the company identified the cobalt smelters in its supply chain and does it disclose this list? If not, why? If yes, to what extent is this information disclosed (e.g. names of suppliers/smelters, geographical location)?
- How frequently is this exercise undertaken and what combination of self-checks or reporting, third-party, or company audits are used to verify this information? How is it ensured that this process is viable over time?
- Does the company know what proportion of its indirect cobalt supply is (a) of DRC origin and (b) artisanally sourced from the DRC? If no, why not? If yes, with what confidence is this information known and with what frequency is this assessed?
- Using the OECD due diligence guidance, has the company assessed what percentage of DRC-origin cobalt in its supply chain is connected to ASM?
- How does the company prioritise which risks to focus on in its human rights risk assessments?
- Has the company conducted human rights risks assessments in its cobalt supply chain? Does the company disclose a summary of the findings of these assessments? If the company does not conduct human rights risks assessment or disclose the assessment results, is it able to explain why not?
- What are the established procedures or guidelines that determine the response to finding human rights/child labour violations?

SUPPLIER RELATIONSHIPS (DOWN TO SMELTER/ REFINER LEVEL)

- Has the company established a supplier code of conduct that reflects relevant international standards such as the ILO core standards (that covers child labour)? Does this supplier code of conduct apply to all suppliers and sub-suppliers?
- Is the supplier code of conduct approved at senior level and is it reviewed on a regular basis to ensure it addresses all identified risks?
- How does the company assess whether its suppliers comply with the expectations articulated in its supplier code of conduct? Does it check compliance via independent third-party audits? If not, why? If yes, how often?

HUMAN RIGHTS RISK ASSESSMENT AND DUE DILIGENCE – UPSTREAM

EXPECTATIONS FOR UPSTREAM COMPANIES

- Trace cobalt back to mining sites and identify the circumstances of extraction, trade, handling and export of the mineral.
- Provide the information resulting from due diligence and mapping of the supply chain to downstream customers and publicly disclose them.
- Smelters/refiners should have a chain of custody or traceability system in place down to the mining sites.
- Submit themselves to regular independent third-party audits to monitor compliance with international standards and disclose the results of these audits to downstream customers.

KEY QUESTIONS FOR UPSTREAM COMPANIES

Supply chain mapping and due diligence

- Has the company mapped its supply chain down to mine level? Has it identified a list of suppliers down to mine level and does it disclose this list? If yes, to what extent (e.g. only to customers or publicly available)? If no, why not?
- Does the company know its exposure to cobalt sourced from the DRC? If no, why not? If yes, with what confidence is this information known and with what frequency is this assessed?

ASM and human rights risk assessment

- Has the company identified salient and material human rights risks in its cobalt supply chain? If yes, what mechanisms has the company put in place to address and mitigate these risks?
- Using the OECD due diligence guidance, has the company assessed what percentage of DRC-origin cobalt in its supply chain is connected to ASM?
- Has the company engaged directly with traders or has it leveraged its suppliers to engage with them to identify the origin of cobalt and the circumstances in which it was mined?
- What measures does the company take to ensure that the mining conditions are optimal and payment is regular and fair? Is this through receipt of certificates from suppliers, its own checks, third-party audits? How frequently and across what extent of the chain is this carried out? Responses may include work already done and to be done.

Monitoring supplier compliance

- How does the company assess supplier compliance with its code of conduct? Is a third party involved in the monitoring?
- How does the company address identified cases of non-compliance? Does the company support suppliers in adopting good practices (e.g. through training and capacity building)?

Disclosure and communication with downstream customers

- How does the company communicate with downstream customers on the origin of the cobalt?

HOW TO RESPOND TO AND REMEDY HUMAN RIGHTS VIOLATIONS

Under relevant international standards (e.g. UN Guiding Principles on Human Rights), companies have the responsibility to mitigate or remediate any negative impact caused – directly or indirectly by their activities.

Ceasing relationships with problematic suppliers or ceasing to source from the DRC or from ASM does not constitute a proper mitigation practice. Companies can work with problematic suppliers so they are equipped to deal with the issues in their operations. However, when suppliers fail to comply after repeated attempts, there may be reasonable ground for companies to suspend sourcing from that supplier.

APPROACHES TO REMEDIATION

- Partnering with civil society organisations and/or governmental institutions to remedy any identified violations.
- Development approach – funding relevant programmes/projects in the community.
- Working with local cooperatives to ensure fair compensation of miners.

KEY QUESTIONS FOR COMPANIES

IDENTIFIED CASES OF HUMAN RIGHTS VIOLATIONS/NEGATIVE IMPACT

- How does the company respond when it finds evidence of human rights violations in its supply chain? Does the company intend to cut out those parts of the supply chain or encourage that its suppliers do so? If yes, what is the company's view on the socio-economic outcomes of that choice?
- Has the company identified instances of such violations? Has it acknowledged them publicly? Has it engaged with other stakeholders (DRC national and provincial governments/civil society, NGOs/affected stakeholders) to find adequate solutions and provide remediation? E.g. has the company considered ways to help children back into school while continuing to pay them a salary to ensure their quality of life is not affected?

UPSTREAM/ON THE GROUND REMEDIATION

- Given its previous/ongoing/intended reliance on cobalt sourced from the DRC and the potential for this material to be linked to human rights/child labour risks, does the company engage in supporting upstream development/remediation activity in cobalt mining regions in the DRC? If not, explain the rationale for that choice?
- If the company engages in such activities, is it able to provide more details regarding:
- Direct or indirect nature of the support; and whether it is individual or collaborative (can the company explain the choice of either).
- Organisations/stakeholders that it may be partnering with (e.g. NGOs, governments).
- Scope of the support, including focus areas (education, training, other).
- Does the company assess the impact of these programmes? If yes, how often?

COLLABORATING THROUGH INDUSTRY INITIATIVES

Joining and actively participating in industry initiatives allows companies to have a dialogue with peers, benefit from knowledge sharing platforms and combine efforts to tackle common challenges.

EXISTING INITIATIVES

- Responsible Minerals Initiative (RMI), formerly the Conflict-Free Sourcing Initiative (CFSI)
- Responsible Cobalt Initiative (RCI)
- Cobalt Institute – Responsible sourcing initiative in partnership with RCS Global
- Global Battery Alliance, World Economic Forum
- European Partnership for Responsible Minerals
- Raw Materials Observatory – Drive Sustainability, partnership between automotive companies coordinated by CSR Europe

All these initiatives refer to the OECD Guidelines for Multinational Enterprises and work collaboratively to ensure that their objectives, plan of action and the tools made available to companies are aligned. It is particularly important that downstream companies across different sectors align their expectations towards upstream suppliers to avoid replicating compliance standards.

While companies may derive benefits from participating in a multi-stakeholder initiative, they still bear an individual responsibility to respect human rights in their supply chain. Therefore, membership alone cannot be considered evidence of proper risk mitigation.

KEY QUESTIONS FOR COMPANIES

- Which initiatives in the cobalt space does the company find useful (or not)?
- Is the company a member of any industry initiative related to the responsible sourcing of cobalt?

IF YES...

- In which multi-stakeholder or external partnerships is the company involved?
- Can the company explain the rationale behind its choice?
- How frequently and in what manner does the company intend to participate in the initiative (e.g. active participation, chair, founding member)?
- Does membership require CEO and/or chairman endorsement?
- What does the company seek to obtain through its participation?
- Is the company actively contributing – or plan to contribute – to the activities of the initiative? If yes, in what manner?

IF NOT...

- What is the rationale behind the company's choice not to get involved in any of the existing initiatives?
- Has the company been conducting other forms of stakeholder engagement related to responsible sourcing of cobalt?

FURTHER RESOURCES

- OECD:
  Due diligence guidance for responsible supply chains of minerals from conflict-affected and high-risk areas
- OECD:
  Responsible business conduct for institutional investors – key considerations for due diligence under the OECD guidelines for multinational enterprises
- OECD:
  Practical actions for companies to identify and address the worst forms of child labour in mineral supply chains
- Amnesty International:
  This is what we die for
- Amnesty International:
  Time to recharge
- CEGA report:
  Artisanal Mining, Livelihoods, and Child Labour in the Cobalt Supply Chain of the Democratic Republic of Congo
- Global Witness:
  Time to dig deeper
- RCS Global:
  The battery revolution: balancing progress with supply chain risks
- RCS Global:
  The emerging cobalt challenge

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The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org

The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

United Nations Global Compact

The United Nations Global Compact is a call to companies everywhere to align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take action in support of UN goals and issues embodied in the Sustainable Development Goals. The UN Global Compact is a leadership platform for the development, implementation and disclosure of responsible corporate practices. Launched in 2000, it is the largest corporate sustainability initiative in the world, with more than 8,800 companies and 4,000 non-business signatories based in over 160 countries, and more than 80 Local Networks.

More information: www.unglobalcompact.org