

# Responsible Sourcing: LME position paper

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An HKE~~X~~ Company

SETTING THE GLOBAL STANDARD





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## 1. EXECUTIVE SUMMARY

The global focus on responsible sourcing has gained increasing momentum over recent years, with an escalation of interest driving both public awareness and consumer demand for assurances as to the provenance of resources and materials. Concurrently, the London Metal Exchange (“LME” or the “Exchange”) has been working with a variety of industry bodies in order to understand the issues and contribute to the debate as appropriate.

To facilitate this work, in 2017 the LME conducted a comprehensive responsible sourcing survey with all producers of its listed brands; that is, brands assessed by the LME as being eligible to be delivered against contracts traded on the Exchange. The results of this survey, alongside market feedback, suggest that it is now appropriate for the LME to take more practical action to ensure that its listed brands do not just meet the physical requirements of shape, weight and chemical composition, but are also compliant with industry best standards in respect of responsible sourcing.

This position paper is the result of the LME’s market engagement process to date, and indeed has been reviewed by a number of core stakeholder organisations in the area of responsible sourcing. It lays out the LME’s proposed pathway for ensuring that its listed brands appropriately embody the standards expected by the global industry and its downstream fabricators and consumers.

In essence, the LME is proposing that all of its brands undertake an assessment against the red flag indicators set out by the Organisation for Economic Co-operation and Development (“OECD”). Any brands where this assessment indicates a higher risk in respect of metal sourcing practices would be expected to undertake an audit against an industry standard which has been shown to incorporate the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, or equivalent (“OECD Guidance”). Furthermore, and given the greater industry focus on two specific metals (cobalt and tin), the LME will expect all brands of these metals to undertake such an audit.

It is not the intention of the LME to publish its own standard; rather, it will allow those producers requiring an audit to elect an existing standard (which may be an appropriately verified internal standard) which has been independently assessed as being consistent with the OECD Guidance. The LME fully recognises that standards are currently being produced across its suite of metals, and will ensure that its proposed timing respects the period required for such standards to be established. The LME will then work with its producers through a period of engagement to ensure that all such producers are compliant with their chosen standard. Subsequently, the LME will have the power to delist brands which are not in compliance with the new requirements.

The LME notes specifically the market concerns in respect of cobalt, and is further proposing a mechanism whereby cobalt brands which are exerting a demonstrable negative impact on LME pricing (which may be due to market concerns as to the sourcing activities of that brand) may be subject to action at an earlier date.

Finally, in response to greater industry awareness as to environmental and occupational health and safety considerations, the LME will also require ISO 14001 and OHSAS 18001 (or successor) certification.

Full details of the LME’s proposal are outlined in Section 5, and the Exchange would welcome feedback from the market on its proposed path forward. Any such comments should be addressed to [responsiblesourcing@lme.com](mailto:responsiblesourcing@lme.com), no later than 30 November 2018.

## 2. RESPONSIBLE SOURCING

This section sets out the LME's summary of the responsible sourcing topic. The analysis and views are those of the Exchange; however, it is believed that this represents an effective summary of current global views of the matter.

### 2.1. Background

Global focus on responsible sourcing has gained increasing momentum over recent years, with an escalation of interest driving both public awareness and consumer demand for assurances as to the provenance of resources and materials.

In response, multinational corporations have begun to consider their sourcing responsibilities to be broader than the traditional remit of costs, delivery time and quality of materials, to incorporate sustainability concerns from across the environmental, social and governance ("ESG") spectrum. Complexities in this space include a broad range of national and supra-national policies, standards and guidance documents, providing a diverse set of categorisations of both the issues, and their potential solutions.

The extent to which the global focus on responsible sourcing has gained traction is evident through the wide-reaching scope of various responsible sourcing initiatives, ranging from an information-only model whereby the obligation is simply to identify the origin of all goods, to ensuring that these goods are sourced in a manner which is consistent with particular standards. This range is further complicated by the proliferation of global, regional, national and local standards and regulations which can cover particular resources or groups of resources, as well as industry-specific or more general processes. All of these factors can then be considered against a spectrum of socially responsible concerns incorporating human and labour rights, health and safety, environmental concerns and best practice governance.

### 2.2. Mining and metals

The mining industry, as the sector responsible for the extraction of natural resources, is at the forefront of the responsible sourcing debate. While work on this subject has been underway for many years, recent regulatory focus on the topic has meant that companies operating along the metals value chain are under increasing pressure to be able to appropriately diligence their supply chains and evidence that their materials are conflict free, and sourced using best practice and responsible standards. Initial industry focus was on mapping supply chains to provide better identification and assessment of risk of "conflict minerals" (that is, minerals extracted from a conflict zone incurring the risk that the profit from that extraction is used to perpetuate such conflict), in order to break the link between mineral extraction, conflict and trade. However, this focus has since expanded to incorporate the broader topic of "responsible sourcing", which includes conflict-free principles, but also considers topics such as the risk of forced labour, the worst forms of child labour, abuse of human rights more generally, money laundering, corruption and bribery. Clearly, the possibility of such abuses is greater in regions also impacted by conflict; however, more broadly, "high risk" areas may not manifest overt conflict, but (due to political instability or weakened institutions) may be more at risk of harbouring such abuses. Other areas frequently considered under the umbrella of responsible sourcing, such as environmental concerns, could be equally important in lower risk jurisdictions. More generally, the LME would suggest that it is appropriate for all participants to ensure that, regardless of their geographical scope, their supply chain has been

fully assessed to identify and manage any such risks; clearly, the risk assessment (and hence standard of diligence required) will differ based on location.

The challenge is further complicated by the clear need to respect the rights of the “artisanal mining” sector – that is, individual miners working independently or in small collectives, rather than under the auspices of a mining company. Artisanal mining may, if appropriately organised, act as a force for social good, allowing local cooperatives, individuals and mining communities to benefit from the natural resources to be found in their local area. However, artisanal miners can be particularly vulnerable to a number of risks, including forced labour, the potential lack of alternative livelihoods and insufficient protection across a broad range of issues including human rights. Furthermore, issues such as child protection and safety standards can be more difficult to monitor in the context of artisanal mining operations because of the smaller scale, locations and nature of the operations, amongst other reasons<sup>1</sup>. To give a sense of the potential scale of this challenge, the World Bank estimates that about 100 million people (including workers and their families) depend on artisanal mining compared to about seven million people worldwide in industrial mining<sup>2</sup>. The Democratic Republic of the Congo (“DRC”), one of the world’s primary sources of cobalt (providing 51% of world production in 2014, as well as 17% of tantalum, 6% of copper and 2% of tin<sup>3</sup>), is estimated to be home to about two million artisanal miners<sup>4</sup>.

It should further be noted that the principles of responsible sourcing are not fixed. It is reasonable to assume that, as time progresses, the standards expected (particularly by the downstream market, including fabricators and consumers) will further develop, and hence the perimeter of responsible sourcing is likely to evolve. In particular, environmental considerations do not currently feature in the OECD Guidance<sup>5</sup>, but clearly figure prominently in the minds of many metals consumers – the relative focus will be driven by the understanding of the materiality of risk as assessed by individual companies or broader industries. This, along with the LME’s proposed scope of its responsible sourcing requirements, is discussed further in Section 5.

The scope of affected minerals is also subject to ongoing evolution. Conflict minerals have typically been defined, as least for the purposes of US regulation<sup>6</sup>, as (i) the four minerals most commonly mined from conflict areas: tin (cassiterite), tantalum (columbite-tantalite, known as coltan), tungsten (wolframite) and gold ore, otherwise known as “3TG”, and which are (ii) mined from the DRC or adjoining countries. More recently, however, these definitions have evolved to incorporate a broader scope in the context of the wider responsible sourcing debate; cobalt, just as one example, has also come under increased focus. As this scope expands, so too does the geographic reach – responsible sourcing is now a worldwide concern, and many responsible sourcing issues can arise in extractive industry wherever located in the world.

Accordingly, it can be seen that the topic of responsible sourcing is a highly complex one, with

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<sup>1</sup> Of course, artisanal mining is also less likely to suffer from certain problems more typically associated with large scale mining such as financial crime

<sup>2</sup> The World Bank. (2013, November 21). *Artisanal and Small-Scale Mining*. Retrieved 29 May 2018, from The World Bank website: <http://www.worldbank.org/en/topic/extractiveindustries/brief/artisanal-and-small-scale-mining>

<sup>3</sup> Yager, T.R. (2017, July). *2014 Minerals Yearbook: The Mineral Industry of Congo (Kinshasa) [ADVANCED RELEASE]*. Retrieved 29 May 2018, from U.S. Geological Survey website: <https://minerals.usgs.gov/minerals/pubs/country/2014/myb3-2014-cg.pdf>, p. 13.1

<sup>4</sup> Eftimie, A., Heller, K., Strongman, J., Hinton, J., Lahiri-Dutt, K., & Mutemer. (2012). *Gender Dimensions of Artisanal and Small-Scale Mining: A Rapid Assessment Toolkit*. Retrieved 29 May 2018, from The World Bank website: <http://documents.worldbank.org/curated/en/644761468157780524/pdf/675200ESWOP1100C0disclosed030150120.pdf>

<sup>5</sup> However, environmental considerations do feature in the OECD Guidelines for Multinational Enterprises, which forms the overarching standard on responsible business conduct for all sectors

<sup>6</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 1502 (“Conflict Minerals Statutory Provision”), sections 1502(e)(4) and 1502(e)(1)

parameters and standards which continue to evolve. However, it is also clear that – notwithstanding varying views on the scope of the debate – the core issue is now of global importance to the integrity of supply chains, and hence must be a topic of focus for all participants in the global metals market.

### 2.3. Development of responsible sourcing initiatives

As might be expected given the evolution of responsible sourcing from the narrower issue of conflict minerals in the 3TG space, those industries which work with minerals predominantly found in conflict and high risk areas have demonstrated a higher degree of concern with issues relating to responsible sourcing, and concomitant progress in respect of process standardisation and transparency. As a result, countries and companies involved in the mining and consumption of 3TG have been at the forefront of efforts to collect full and transparent supply chain information in order to identify, assess and mitigate the risks associated with the spread of illegally traded minerals from conflict areas.

Much of the work in this area has been based on existing initiatives. For example, the precious metals industry has also taken significant steps in this area, led by initiatives such as the London Bullion Market Association’s (“LBMA”) responsible sourcing programme. Since 2012, this has provided mandatory standards on a wide range of responsible sourcing topics, including conflict, for all gold refiners on the LBMA good delivery list designed to ensure that all London gold stocks are compliant with an LBMA-defined audit process.

Of course, it is worth noting that metals do not represent a homogenous group and that different facets of the responsible sourcing debate provide varying levels of concern for each metal, as evidenced by a wide range of metal-specific standards.

### 2.4. Categorising current initiatives

The LME believes that the current set of initiatives can be most appropriately characterised according to the following hierarchy and taxonomy:

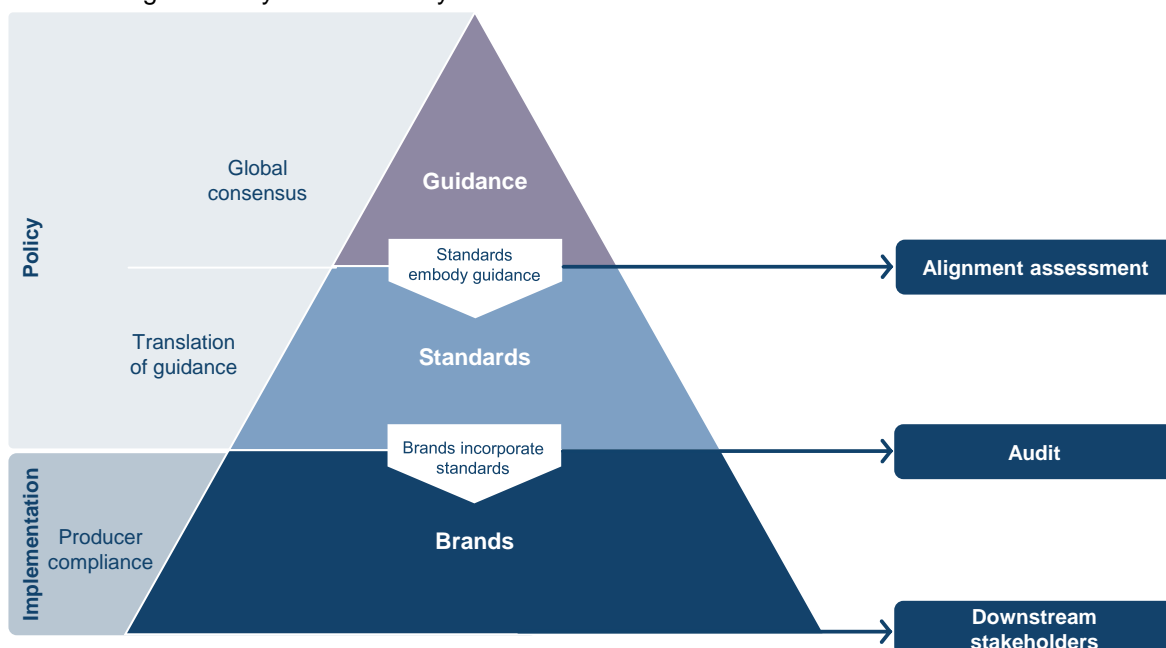


Figure 1: LME categorisation of existing responsible sourcing initiatives

- **Guidance.** Guidance provides benchmarks and high-level statements of intent in respect of responsible sourcing. It should be appropriately broad so as to be applicable across regions and across materials; however, it must also be sufficiently explicit so as to allow the guidance to be transcribed into implementing standards. The set of guidance which, in the assessment of the LME, has seen broadest global adoption, including at the governmental level, is the OECD Guidance<sup>7</sup>. A key observation in respect of the OECD Guidance has been its influence on other guidance – most notably (but not exclusively), the Chinese Due Diligence Guidelines for Responsible Mineral Supply Chains, as developed by the China Chamber of Commerce of Metals, Minerals and Chemicals Importers and Exporters (“CCCMC”). These guidelines are applicable specifically to Chinese companies, but are closely aligned with the OECD Guidance.

It should be further noted that there exist alternative sets of guidance – for example, that promulgated by the International Council on Mining and Metals (“ICMM”). It is the current position of the LME that, in order to minimise the potential for a divergence of guidance, the OECD Guidance should represent the core basis. However, the LME recognises that OECD Guidance may itself be incorporated into other sets of guidance, which can then act as the basis for standards.

Furthermore, guidance may also contain a set of risk indicators, which can be used to assess the relative need for guidance implementation, based on the underlying risk factors. For example, the OECD Guidance contains a set of “red flags” (the “OECD Red Flags”)<sup>8</sup>, which can be used to determine whether elevated risks are manifested

- **Standards.** Standards contain more granular articulation of the steps which supply chain participants should take in order to ensure alignment with relevant guidance. Because of the need for detail, a range of standards will be required, along the following main axes:
  - **Metal-specific or multi-metal.** Given the specificities of certain metals, a single-metal standard may be appropriate in these cases
  - **Regional or global.** Certain standards will have global applicability; others will be regional in nature
  - **Mandated or voluntary.** Certain standards have legal force in certain jurisdictions. Given the lack of a global legal structure, such standards are (by definition) regional in scope, although may have an extra-territorial effect given the nature of global supply chains. For example, the European Union (“EU”) Conflict Minerals Regulation (coming into effect on 1 January 2021) has the aim of ensuring that EU importers of 3TG meet the OECD Guidance. Similarly, Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) covers conflict minerals, and requires all companies which report to the US Securities and Exchange Commission (“SEC”) to file an annual report to the SEC disclosing their use of conflict minerals that originated in the DRC or any adjoining country
  - **External or internal.** Although the most widely known standards will be external (that is, set by a trade body or other organisation external to the producers which will comply with

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<sup>7</sup> It should be noted that governments adhering to the Recommendation of the OECD Council on Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas commit to actively promote the observance of the Guidance by companies operating in or from their territories and sourcing minerals from conflict-affected or high-risk areas. Furthermore, the OECD Guidance has two specific supplements – the first relating to tin, tantalum and tungsten, and the second relating to gold. Considering the universe of LME base metals, requirements attaching to tin clearly will incorporate the provisions of the OECD Guidance Supplement on Tin, Tantalum and Tungsten

<sup>8</sup> The OECD Red Flags are contained in the OECD Guidance Supplement on Tin, Tantalum and Tungsten. However, the LME believes that these OECD Red Flags have general applicability for all of the LME’s base metals, and indeed proposes to utilise the OECD Red Flags as the first-line determinant of risk for most of its listed brands



the standard), the LME does not exclude the possibility of producers working towards internal standards (that is, devised by the producer itself). Furthermore, certain internal standards are based on external standards; however, in the view of the LME, these should still be considered internal standards, given that they will not necessarily deliver all of the features of the external standard on which they are based

- **Alignment assessment.** Alignment assessment is the process by which a given standard is assessed to capture appropriately the relevant guidance, pursuant to the OECD's "Methodology for the Alignment Assessment of Industry Programmes with the OECD Minerals Guidance". This alignment assessment will be undertaken by an independent external alignment assessor.

An OECD-run pilot process has now completed, as part of which, five standards were assessed as to their conformance with the OECD Guidance. Given, however, the plethora of standards, it is to be expected that the OECD will not take responsibility for assessment of all standards, and hence that standards bodies may themselves need to demonstrate alignment with the guidance which they hope to embed.

It should be noted that alignment assessment is not a "binary" process – it is likely that a given standard will fulfil certain elements of the alignment assessment process, but not others. Accordingly, there will always be an element of discretion which must be applied by a relevant authority in determining whether to accept as "successful" the outcome of a particular alignment assessment process

- **Implementation.** Implementation is the process by which a metal producer (and, of greatest interest to the LME, the producer of a current or prospective LME-registered metal brand) implements a specific standard – and, by extension, the guidance on which such standard is based
- **Audit.** Audit is the process by which a third party assesses compliance of a given brand with its chosen standard. The audit process (in respect of requirements, frequency and allowed auditors) will be laid out in the particular standard (and, by extension, will have been covered by the standard's alignment assessment). The frequency of the audit requirement will vary between standards, with some not requiring further audit once the initial certification is complete, and others requiring a regular due diligence process to ensure that standards are being met on an ongoing basis.

As with alignment assessment, the results of an audit will not be "binary" – it will be necessary for the audit report to be assessed by a relevant authority, and a decision reached as to the sufficiency of the audit outcome. In respect of an external standard (e.g. a standard created by an industry body), it would be expected that the body itself would identify a process by which audit reports would potentially be considered by an independent panel constituted by that body. However, in respect of an internal standard (i.e. created by a particular producer), there would not be an obvious route within the standard for the consideration of the audit report, and an alternative approach would therefore have to be found<sup>9</sup>.

It should be emphasised that the adoption of, and successful delivery of an audit in, a specified standard does not represent an "outsourcing" of an organisation's responsible sourcing requirements. The LME's view is clear – namely that its listed brands retain responsibility for the appropriateness of their responsible sourcing arrangements – and, indeed, the OECD Guidance

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<sup>9</sup> In the case of the LME's approach, this would be undertaken by the LME itself, as further set out in Section 5.4.3



emphasises the need for reporting on supply chain due diligence, so that these responsibilities can be embraced in a public context

- **Downstream stakeholders.** A broad set of stakeholders will have an interest in the choice and implementation of standards by a given brand, and the certification thereof. Most importantly, users of the metal (and, eventually, the end consumer) will expect assurance that the metal is, indeed, responsibly sourced

Notwithstanding the extent of existing efforts, the complexity of tracking specific minerals from mine to consumer should not be underestimated; ore mined in the DRC, for example, can be shipped globally multiple times to undergo various stages of fabrication before final use. As an example of the scope involved, Apple has mapped its 3TG and cobalt supply chains from smelter to manufacturing as part of its drive to assess and address risks. In 2017, 100% of its identified smelters – 260 in total – participated in independent third-party audits to ensure that minerals in Apple products are responsibly sourced<sup>10</sup>. Apple, as with many companies filing with the SEC, has also published a complete list of the smelters with which it does business as part of its drive for transparency.

As might be expected, this is not a topic without its controversies, and the debate over the potential unintended consequences of attempts to break the causal link between mining and social harm is ongoing. This has centred on the potentially unfair or unjustified portrayals of mining in post-conflict regions, the mischaracterisation or generalisations made in respect of artisanal mining, the economic and social consequences of the loss of mining from communities, and the resulting monopolisation of mining under enterprises which exclude independent miners. The reporting element has also not been straightforward, with the US Court of Appeals for the District of Columbia ruling in 2014 that certain elements of the SEC filing procedure violate the First Amendment, and US House of Representatives voting to pass the Financial Choice Act in May 2017, which, amongst other provisions, includes the repeal of Section 1502 of Dodd-Frank. This leaves the regulatory future of responsible sourcing with an uncertain future in the US. Despite this uncertainty, however, the drive for greater transparency and the globalisation of minimum standards seems unlikely to slow.

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<sup>10</sup> Apple Inc. (2018). *Apple Supplier Responsibility 2018 Progress Report*. Retrieved 1 June 2018, from Apple website: [https://images.apple.com/euro/supplier-responsibility/g/generic/pdf/GBEN\\_Apple\\_SR\\_2018\\_Progress\\_Report.pdf](https://images.apple.com/euro/supplier-responsibility/g/generic/pdf/GBEN_Apple_SR_2018_Progress_Report.pdf)

## 3. THE LME AND RESPONSIBLE SOURCING

### 3.1. LME remit on responsible sourcing

The LME is the world centre for the trading of industrial metals. Regulated by the Financial Conduct Authority (“FCA”) and firmly rooted in the physical industry, the LME facilitates the transaction of the majority of all non-ferrous metal futures business. Since 2015, the LME has expanded its product range and now offers cash-settled contracts in ferrous metals and physically settled contracts in precious metals, alongside its traditional footprint in physically settled non-ferrous and minor metals.

In addition to pricing and hedging, the LME also acts as a market of last resort, authorising and auditing a physical network of 29 warehouse companies across 34 global locations to warrant and store metal on behalf of metal owners. This warranted metal can be used for the settlement of open trading positions on the LME.

The LME physical network relies on the buyer being guaranteed a consistent standard of a specific metal. To ensure reliable quality, all metal delivered into LME-approved storage facilities must be an LME-approved brand and conform to specifications on quality, shape and weight. Before being listed as an LME brand, a metal must be fully assessed and certified as being compliant with LME requirements. Furthermore, because the LME’s brand lists are frequently referenced in bilateral physical supply contracts, they fulfil a broader role across much of the metals industry in identifying the “acceptable” brands of metal in the market.

In setting the specifications for these criteria, the LME has always considered that its role is to reflect the needs of the market. As well as working with the market to identify the appropriate point along the value chain at which to set the price (with premiums or discounts added depending on where that metal sits along the value chain), the LME will also work with producers and consumers to understand which chemical specification best meets the requirements of the industry. This is metal-specific; for example, zinc purity must be 99.995% grade, whereas nickel purity is 99.80%, but for all metals a full chemical breakdown is provided with minimum standards required.

The LME is fully cognisant of the fact that markets evolve, and that as a result, the requirements for a particular metal specification may also need to adapt in order for that specification to continue to meet market needs. To facilitate this process, and to maintain close collaboration with the market for each metal, the LME operates a series of metal-specific committees. Following market or committee feedback, the LME will undertake a comprehensive investigation of the metal in question and, should the evidence suggest a change is required, will act in collaboration with the relevant metal committee to propose a change to the specification of a particular metal. This is usually to amend the deliverable shapes, but can also act to list or delist particular brands or shapes.

In this way, the LME does not consider itself to lead the market in a particular direction, or to become the arbiter of the “right” specification of metal. Rather, its role is to provide a service and to adapt that service as the needs of the market evolve. This process is also critical to the ongoing orderly functioning of the LME’s market. Should the LME’s metal specification not reflect that of metal used in the physical market, over time, the LME price will also move away from reflecting the “real world” price of that metal, i.e. the price paid by consumers for physical tonnage.

To date, these specifications have been focused primarily on the physical qualities of the metal; that is to say, shape, brand, quality and chemical composition. It has not included any consideration of broader factors such as environmental, social, or governance concerns which have gained increasing

prominence over recent years. However, the LME has remained aware of the progress of the discussion on these factors, and has been working with various responsible sourcing initiatives to contribute where appropriate, and to remain up-to-date on the progress and strength of market sentiment.

### **3.2. LME work to date**

The LME has been engaged with both international policy makers and industry bodies in the debate regarding the responsible sourcing of minerals for several years.

From a regulatory perspective, in respect of both Section 1502 of the Dodd-Frank Act in 2012 (regarding company disclosure of information regarding mineral sourcing from the DRC and adjoining countries), and the European Commission regulation on conflict minerals finalised in May 2017, the LME advocated to ensure the specificities of the LME and its market were fully considered in what is a very complex subject area. However, the LME has always been clear that its role is not (through the use of its brand lists) to give extraterritorial application to any one country or region's legislation in respect of responsible sourcing; rather, the LME should only act on the basis of true global consensus.

More broadly, the LME has always worked closely with the OECD; firstly ahead of the original publication of the OECD Guidance in 2011, and subsequently as a participant in the OECD Portal for Supply Chain Risk Information Expert Group. The LME currently sits on the OECD Multi-stakeholder Steering Group ("MSG").

Feedback from these interactions, and in light of the fact that (i) the market appeared to be moving in a direction in which the ability to provide supply chain transparency had become a prerequisite for the ongoing provision of services along the value chain, and (ii) the LME's role in reflecting the sentiment of the market, both in principle and from a more practical standpoint, in 2017 the LME initiated a process to consider more formally whether an adjustment to its metals specifications and brand listing guidelines would be appropriate. As a result of this, and in order to fully explore its options in this respect, in November 2017 the LME launched a responsible sourcing survey.



## 4. LME RESPONSIBLE SOURCING SURVEY

On 15 November 2017, the LME sent a responsible sourcing survey to the producers of all of its listed brands<sup>11</sup> asking for their feedback on the following topics:

- Have you previously or are you currently participating in any certification / auditing programmes with regard to the responsible sourcing of your metal?
- Do you have your own Code of Conduct or follow any industry association / organisation code of conduct with regard to incorporating responsible sourcing into your company / operational practices and processes?
- What responsible sourcing audit / certification requests or compliance documentation are you currently being asked to provide to your downstream supply chain?
- The LME is continuing to evaluate and monitor the impact of responsible sourcing as an Exchange, and would therefore value any input you have on the various auditing schemes / codes of conduct connected with responsible sourcing or any comments you wish to make on the subject

The LME also noted that it is an existing LME requirement for a producer to have an ISO 9001 (quality management) certificate for its plant. Given that the LME is considering the introduction of a requirement to hold up-to-date ISO 14001 (environmental management) and OHSAS 18001<sup>12</sup> (occupational health and safety management systems) certification, producers were also asked whether their operations were already certified under these programmes and, if so, to provide copies of the relevant documentation.

The deadline for responses was 1 December 2017, although the LME has continued to work with its producers to ensure it receives as many responses as possible in order to inform its thinking as it shapes its position on the topic of responsible sourcing. However, even on the basis of the responses received as of 1 June 2018, the LME believes that it now holds the most comprehensive global source of data on producer responsible sourcing compliance, which will be of material assistance in monitoring the path to compliance of the LME's listed brands.

Sections 4.1 to 4.7 provide statistical summaries of responses received to the responsible sourcing survey on a per-metal basis<sup>13</sup>, as well as further analysis where points of interest have emerged.

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<sup>11</sup> As the market is aware, the LME has been in discussions with stakeholders as to the possibility of replacing its physically settled molybdenum contract with a cash settled alternative. For this reason, the responsible sourcing survey was not sent to producers of molybdenum listed brands. However, because a final decision on this topic has not yet been communicated to the market, the LME's responsible sourcing proposals do include molybdenum, although clearly in the event of a transition of the contract to cash settlement, these requirements would not apply

<sup>12</sup> The International Organization for Standardization is in the process of replacing OHSAS 18001 with the first global occupational health and safety management system – ISO 45001. Organisations are expected to migrate to ISO 45001 over the next three years and the LME will monitor this transition with its brand producers. For more information, see <https://www.iso.org/iso-45001-occupational-health-and-safety.html>

<sup>13</sup> All response statistics are accurate of 1 June 2018 and are based on "live" LME brands; that is, brands which are eligible for good delivery on the LME, as of 1 June 2018. This excludes suspended or delisted brands, and brands for which notice of future suspension has been issued to the market

#### 4.1. Aluminium (primary, aluminium alloy and NASAAC)

PRIMARY ALUMINIUM	
Listed brands	94
Unique producers	48
Unique producer respondents	22
% response	46%
<b>Identification of standard (respondents only)</b>	
External standard	8
<i>Aluminium Stewardship Initiative</i>	7
<i>Association of Materials Management, Purchasing and Logistics (or BME)</i>	1
Internal code of conduct	9
None identified	5
ALUMINIUM ALLOY	
Listed brands	63
Unique producers	49
Unique producer respondents	24
% response	49%
<b>Identification of standard (respondents only)</b>	
External standard	2
<i>Aluminium Stewardship Initiative</i>	2
Internal code of conduct	13
None identified	9
NORTH AMERICAN SPECIAL ALUMINIUM ALLOY CONTRACT (“NASAAC”)	
Listed brands	61
Unique producers	47
Unique producer respondents	21
% response	45%
<b>Identification of standard (respondents only)</b>	
External standard	4
<i>Aluminium Stewardship Initiative</i>	4
Internal code of conduct	11
None identified	6

As with a number of metals, the perspective of primary aluminium, aluminium alloy and NASAAC producers on responsible sourcing is less focused on conflict minerals (given that bauxite is not generally sourced from conflict areas), than it is on environmental and governance questions. In particular, the high levels of energy required for aluminium production mean that questions of environment and sustainability are predominant in the industry, followed closely by concerns such as biodiversity and indigenous people’s rights.

For the aluminium market, it is the LME’s understanding that work has coalesced under the Aluminium Stewardship Initiative (“ASI”) which has formed an industry consortium of key stakeholders and interested parties to collaborate on the core issues facing the industry, and to articulate a route forward to address those issues. The ASI Performance Standard is structured on three core principles: governance, the environment and social matters, and includes a certification process supported by an assurance model. ASI has also developed a Chain of Custody Standard that can track the flow of material through aluminium value chains.

## 4.2. Cobalt

COBALT	
Listed brands	9
Unique producers	8
Unique producer respondents	5
% response	63%
<b>Identification of standard (respondents only)</b>	
External standard	1
<i>Corporate Social Responsibility Label of General Confederation of Moroccan Companies</i>	1
Internal code of conduct only	2
None identified	2

Responses from cobalt producers indicate that the industry has taken significant steps to address concerns about providing appropriate due diligence of its supply chain, with labour welfare issues, particularly the worst forms of child labour, as the foremost concern, and environmental and security considerations secondary.

Importantly, there is significant development of new initiatives in the cobalt space, with two in particular mentioned in the responses:

- CCCMC which produces due diligence guidelines for responsible mineral supply in China, the Responsible Minerals Initiative (RMI), and the Responsible Cobalt Initiative (“RCI”) have partnered to help ensure the responsible production, trade and processing of cobalt by developing a cobalt refiner assurance process to assess conformance against the OECD Guidance
- Cobalt Institute (“CI”, formerly the Cobalt Development Institute), a non-profit trade association promoting the sustainable and responsible production and use of cobalt in all forms. The CI is currently drafting the Cobalt Industry Responsible Assessment Framework (“CIRAF”) through which companies can use existing standards and certifications to demonstrate compliance with responsible sourcing principles

While no respondent indicated in their response that they are actively working towards either standard, subsequent discussions with the LME suggest that these initiatives will see significant industry uptake in due course.

## 4.3. Copper

COPPER	
Listed brands	92
Unique producers	49
Unique producer respondents	36
% response	73%
<b>Identification of standard (respondents only)</b>	
External standard	0
Internal code of conduct only	26
None identified	10

Responses from copper producers indicate that they do not participate in any external certification or auditing programmes, and that this is attributable to a number of reasons, including (i) a clear and



identifiable existing supply chain which does not touch conflict areas, or (ii) confidence that their internal policies, procedures and codes of conduct provide adequate assurance of their due diligence.

Of the producers who had existing policies, a number of key themes emerged along the lines of industry standards including human and labour rights; environmental rights; and business practice such as confidentiality, and anti-corruption. In respect of supplier due diligence, the LME understands that a number of checks have been introduced, including pre-qualification checks, contractual arrangements which build in compliance with the client code of conduct, or tangible evidence of the supplier’s own policy, systems of receiving and addressing queries and ongoing monitoring – all designed to ensure the chain of custody meets the standards of the client. These systems and processes are frequently then backed up by external audit or assurance programmes conducted on at least an annual basis.

#### 4.4. Lead

LEAD	
<b>Listed brands</b>	85
<b>Unique producers</b>	66
<b>Unique producer respondents</b>	32
% response	48%
<b>Identification of standard (respondents only)</b>	
External standard	1
<i>Chartered Institute of Procurement and Supply</i>	1
Internal code of conduct only	18
None identified	13

For the lead industry, notwithstanding various country-specific regulations (especially those related to cleaner production and effective waste management), producers described a broad spectrum of approaches to a variety of standards.

The majority of producers reported that they rely on their own or their parent company codes of conduct and production standards. More broadly, the lead production industry does not seem to be subject to the same level of demand for due diligence and transparency of chain of custody as other metals.

#### 4.5. Nickel

NICKEL	
<b>Listed brands</b>	20
<b>Unique producers</b>	13
<b>Unique producer respondents</b>	12
% response	92%
<b>Identification of standard (respondents only)</b>	
External standard	1
<i>Towards Sustainable Mining</i>	1
Internal code of conduct	10
None identified	2

As with aluminium, the nickel industry demonstrates a greater focus on environmental issues than conflict minerals. Producers in the nickel industry generally rely on internal standards and charters to govern their production and manage their supply chain, with some producers assessing their compliance using external auditors.

#### 4.6. Tin

TIN	
Listed brands	22
Unique producers	17
Unique producer respondents	10
% response	59%
<b>Identification of standard (respondents only)</b>	
External standard	9
<i>Responsible Minerals Initiative (formerly Conflict-Free Sourcing Initiative)</i>	9
Internal code of conduct only	0
None identified	1

Tin, as part of 3TG, has received a considerable degree of focus in respect of responsible sourcing in general, and conflict minerals specifically.

The standard most commonly identified by respondents was the RMI's Responsible Minerals Assurance Process ("RMAP"), which provides advice, audit and assessment of supply chains to enable compliance with global standards for responsible sourcing. This includes a specific protocol for tin and tantalum with which a number of respondents engage; more broadly, RMI has 79 tin smelters and refiners currently participating in RMAP.

The tin industry has also directly addressed these issues in the upstream supply chain via the International Tin Association's ("ITA" – formerly known as the International Tin Research Institute) ITSCI Programme set up in 2009. ITSCI implements due diligence in four countries including the high risk areas of DRC, for a time as the Conflict Free Tin Initiative ("CFTI"), and now successfully and sustainably continues to provide a traceable supply of metal under a transparent risk identification and resolution process also referred to by multinational product manufacturers for reporting under Dodd Frank.

#### 4.7. Zinc

ZINC	
Listed brands	49
Unique producers	35
Unique producer respondents	25
% response	71%
<b>Identification of standard (respondents only)</b>	
External standard	0
Internal code of conduct	16
None identified	9

For zinc, as with primary aluminium, minimal material is sourced from conflict areas and a number of respondents reported that they do not receive requests for information on sourcing practices in respect of zinc primary concentrate. Perhaps as a corollary to this, some zinc producers also reported that they do not have an internal code of conduct in respect of responsible sourcing, nor do they follow an industry standard.

It is perhaps worth noting here that a number of respondents reported concern about the “right” or “appropriate” standard to pick. Given that compliance and associated auditing requirements with such standards can represent a significant body of work, there is understandable reluctance to move forward if such progress could result in potentially wasted time, effort and resource.

Despite this, a number of zinc producers are well placed to deliver clear supply chain statements, backed by full audits or certification programmes, and several have made considerable progress in this respect.

#### **4.8. ISO 14001 and OHSAS 18001 / ISO 45001**

Not all respondents to the responsible sourcing survey addressed the LME’s questions about ISO 14001 (environmental management) and OHSAS 18001 (occupational health and safety management systems) certification (noting that, as outlined earlier in this Section 4, OHSAS 18001 is being replaced by ISO 45001). However, of those that did, 74% already hold ISO 14001 certification, and 53% hold OHSAS 18001. No specific comments were received in respect of these certification requirements.

It should be noted that requirements stemming from the OECD Guidance have applicability through the upstream supply chain. However, it is not the intention of the LME that the requirements around ISO 14001 and OHSAS 18001 / ISO 45001 have the same upstream applicability; rather, it is anticipated that these will apply only to the operations of the listed brand itself.

#### **4.9. Responsible sourcing survey conclusions**

As would be expected, the responses outlined above demonstrate a significant divergence between metals in both scope and focus of concerns, but also in existing progress in responsible sourcing due diligence. The unifying factor across all metals, however, is the call for relevant bodies to work collaboratively to produce cohesive standards which provide clarity and consistency for the market.

What is also clear is that a significant majority of LME-listed producers are already taking action in respect of responsible sourcing, driven either by their own commitment to the topic or by demand from consumers further downstream. A significant proportion of this work has been through the form of internal codes of conduct – many of which are based on, or include, the OECD Guidance (or equivalent), but incorporate a broader range of concerns based on that producer’s specific operation and supply chain needs.



## 5. LME ACTION ON RESPONSIBLE SOURCING

### 5.1. Context for the LME proposal

Given the prevailing market focus, and supported by the results of the LME responsible sourcing survey, the LME does now believe it is appropriate for it to take action in respect of its brand listing requirements. However, the LME is also cognisant of both existing work in progress on responsible sourcing, and of the scale of effort required by producers in order to ensure that their brands are produced in line with the relevant standards. With this in mind, the LME's priority is to ensure its route forward is consistent with work already underway, such that any efforts by the LME complement and enhance progress in respect of responsible sourcing, rather than hinder or further complicate.

As such, the LME views its position as follows:

- The LME has a central role to play because its brand listings are seen as the standard for metals producers. The Exchange has traditionally viewed these standards as being technical and metallurgical in nature; however, it must realise that society now demands more and expand the scope of LME standards to matters of corporate social responsibility. Accordingly, it is now appropriate for the LME to leverage the importance of its brand lists to give further momentum to the global responsible sourcing initiative
- Many respected organisations are providing templates against which specific risks associated with particular metals or metal production processes can be defined, and standards to which producers might conform. The LME's role is not to replicate this work; rather, it is to advance these efforts by encouraging the adoption of appropriate risk assessments and standards by its listed brands. For the avoidance of doubt, the LME is not proposing to draft and propagate its own set of assessments, standards and associated certification regimes. Instead, where necessary (and dependent on appropriate risk assessments), the LME intends to review and assess the existing programmes (and any future such programmes) with which its listed brands elect to comply and in doing so, support market convergence as far as possible to allow downstream users access to consistent and comparable information and assurance
- Change cannot happen overnight; rather, the LME will adopt an approach of engagement and disclosure, brand classification and brand compliance as outlined below in Section 5.4.

### 5.2. Principles underlying the LME proposal

While the LME accepts that it is now appropriate to move forward, its understanding of its role remains that of following the lead of the market. As such, it is equally vital for the LME to define the remit given to it by the market in evolving the setting of its contract specifications. The LME understands and accepts that this evolved scope will, by definition, be subjective. Within the universe of LME stakeholders it is to be expected that there will be a spectrum of opinion, with one end advocating for an evolution that incorporates due diligence on a comprehensive set of ESG concerns, and the other end believing that the existing specifications fulfil the market's requirements and that no modifications in respect of ESG concerns should be taken.

As such, the LME has considered carefully the results of the responsible sourcing survey alongside market sentiment ascertained more broadly through interactions with key stakeholders, and now

believes that the LME listing criteria for approved brands should be expanded to incorporate responsible sourcing principles based on (i) an assessment and identification of risks associated with the production of individual LME brands and (ii) dependent on that risk assessment, appropriate next steps. These next steps will ensure that, where applicable, brands are working consistently with responsible sourcing principles as outlined in the OECD Guidance, which the LME believes has been broadly adopted by the market at this point in time.

In developing its proposed approach, the LME has observed three core principles:

- **Risk-based and proportionate.** As outlined above, risks – and their relative severity – are not uniform across LME-listed metals. The LME’s proposed approach, as fully outlined in Section 5.4, allows for a risk assessment that recognises the specificities of individual metals, and individual brands within that metal, in order to ensure that brands do not spend significant time developing and implementing procedures to defend against risks which are proven to be less relevant, given their risk profile
- **Pragmatic with respect to timing and existing initiatives.** The LME recognises that a number of highly-effective industry initiatives are already underway, and the Exchange’s responsible sourcing requirements should embed and support, rather than duplicate, the work already in progress. It is for this reason that the LME wishes to make use of existing industry standards available to producers, provided that these appropriately embed the OECD Guidance.

In this regard, the LME must ensure that there exists sufficient time for producers to achieve and audit compliance for their relevant brands. This will necessarily mean that the timeline for implementation of the Exchange’s responsible sourcing standards will extend over the coming years – but, in the opinion of the LME, any attempt to accelerate the timeline to satisfy optical considerations risks endangering the long-term sustainability of the responsible sourcing initiative. The Exchange does, however, recognise the more immediate nature of the challenge in respect particularly of cobalt, resulting in the transitional provisions proposed at Section 5.5.

This being the case, it must be recognised that the process of defining standards is better-advanced for certain metals. In general, those metals for which standards are further advanced are those with a higher potential risk profile, and so the LME is proposing a staggered implementation timeline, with brands assessed as being potentially higher risk expected to meet a more accelerated timetable than those assessed to be of lower risk.

While the LME fully envisages the deployment of responsible sourcing requirements across its entire suite of metals, it also acknowledges that certain metals do not yet have broadly available standards which would allow producers to meet their obligations. The LME will work closely with industry bodies and other interested stakeholders to ensure that such standards continue to be developed, and believes that – by issuing its responsible sourcing requirements and setting timelines for compliance – it will act as a catalyst for the standards process

- **Holistic across the various dimensions of responsible sourcing.** Although the LME does not believe that its market is yet asking the Exchange to incorporate a full spectrum of environmental considerations into its brand requirements, it does recognise that for many of its listed brands, these concerns represent a greater risk than some of those outlined in the OECD Guidance. As such, the LME is proposing to progress with an interim step in respect of environmental concerns, and will implement the requirement for producers to achieve certification on the ISO 14001 standard, as well as OHSAS 18001 / ISO 45001 standards. The LME would also be willing to consider equivalent alternative standards, should its stakeholders

prefer, and would be interested to hear market views on this, and proposed equivalent standards, via the feedback process outlined below in Section 6 below.

As a further observation, the LME acknowledges that there are many producers who are already considerably advanced in assessing risk and implementing standards and associated certification programmes across a much broader spectrum of responsible sourcing concerns than those currently prioritised by the LME (based on the OECD Guidance). It is the LME's belief that this is especially true in matters pertaining to environmental issues, and that a considerable number of LME producers have taken significant action to address such concerns. At present, the market appears to reward such initiatives by assigning a premium value to those brands. Over time, to the extent that fabricator and consumer demands evolve in such a manner as to "standardise" these requirements, the LME anticipates that they may be added to its responsible sourcing requirements, subject to market feedback and agreement

### **5.3. LME powers**

At the heart of the LME's responsible sourcing proposal are its powers in respect of its brand lists. If, after industry feedback, it is decided that the LME will embed responsible sourcing principles into its brand listings, then it is a necessary corollary that the LME would have powers over brands which did not observe such principles, in order to (i) encourage compliance, and (ii) protect the market from the potentially negative effects of the continued listing of non-compliant brands.

Given the LME's desire to achieve a responsible sourcing model through cooperation with its producer community, it may be appropriate in the first instance for action to be transparency-based – that is to say, the LME publishing details of brands which have failed to meet certain deadlines. The LME's willingness to take such action will be partially informed by the market consequences; it may, for example, be inappropriate to publish such information if the effect would be to cause such brand to trade at a discount in the market, which could itself impact the integrity of pricing on the LME market.

Ultimately, and if a consensual approach has proved ineffective, the LME's core power is to suspend or delist brands. In either case, the effect would be that no further material of the specific brand could be warranted (or re-warranted) in the LME network. The decision whether to suspend or delist would be informed primarily by the LME's assessment as to whether it were possible for the brand in question to return to a state of compliance, in which case the suspension could be lifted. If this seems unlikely, then a full delisting may be more appropriate.

The mechanism by which the LME would effect a suspension or delisting would, necessarily, depend on the circumstances. In general, the LME aims to give advance notice of a delisting in order to allow the market a period of time (generally three months) to place residual off-warrant stock into the warehouse. However, in the event that this might create a disorderly market – for example, the inflow of significant quantities of lower-quality material into warehouse during the notice period – the LME does have the right to suspend or delist without notice. This is particularly relevant in the context of responsible sourcing whereby a brand which has not made the necessary efforts to meet relevant standards may trade at a significant discount to the broader metal market. This, therefore, may give metal owners a strong incentive to "dump" metal of that brand onto warrant prior to a suspension or delisting. The market should, therefore, be prepared to accept the possibility of an immediate suspension or delisting.

A second question is whether, in the event of a brand being delisted due to non-compliance with relevant responsible sourcing standards, stock of that brand already on-warrant would need to be removed. It is in the nature of the LME’s warehousing and warranting model that metal on-warrant may have been produced some time ago. Given that the LME’s current understanding is that the market views responsible sourcing as a more recent initiative, it is understood that legacy metal may not have been produced under the same responsible sourcing construct. Accordingly, the LME’s base case intention is that it would not be necessary to remove historical metal on the basis that it was not mined in conformance with responsible sourcing principles at the time of production (given that the LME’s responsible sourcing requirements would not have been in force at that time). This would apply to any metal on warrant at the time of the announcement of a delisting or suspension. However, on this topic, the LME does again propose to retain flexibility such that it is able to take a view on a case by case basis, subject to overarching objective criteria.

For the purposes of this document, the LME refers to “Brand Action” to refer to any action of disclosure, suspension or delisting (with or without the removal of stock in warehouse, and with or without a notice period) taken pursuant to the above powers.

### 5.4. LME proposal

The LME’s proposed responsible sourcing framework is based on its analysis of the taxonomy of responsible sourcing initiatives (as set out in Section 2.4), as set out in Figure 2.

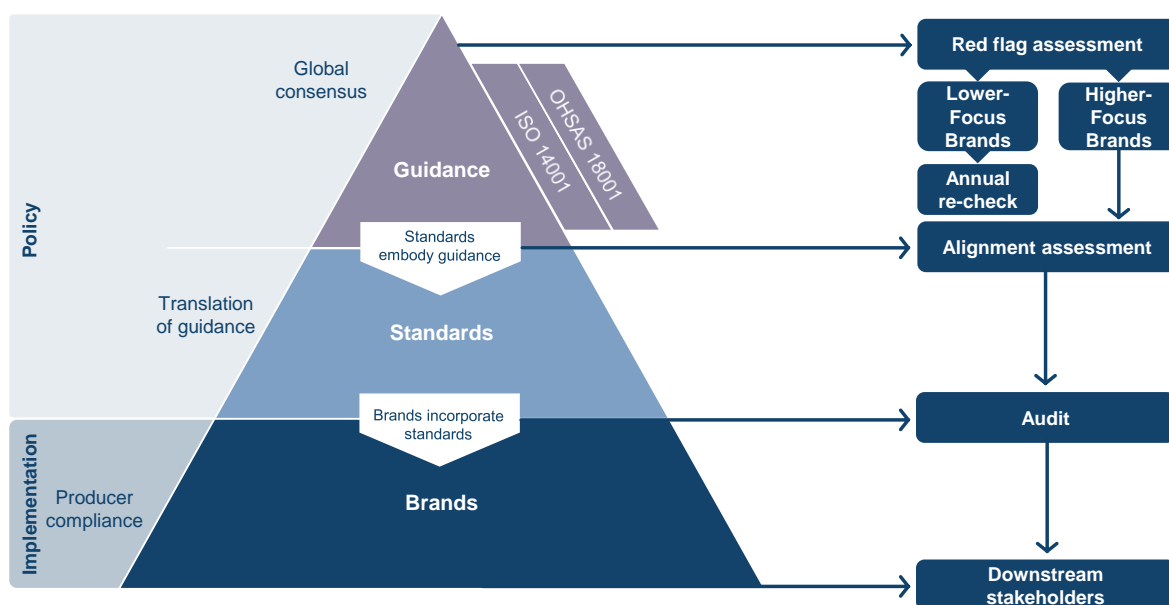


Figure 2: LME proposed framework for responsible sourcing

Brand compliance with the LME’s proposed framework is achieved by means of the steps outlined in Figure 3.

At each step, the LME will assess the compliance of brands with the relevant step, and will have the power to take “Brand Action” (as more fully defined in Section 5.3) in the case of brands which are non-compliant. The proposed deadlines for each step are set out in Section 5.7.



Figure 3: LME compliance steps

#### 5.4.1. Engagement and disclosure

Building on the work already undertaken through the LME responsible sourcing survey, the LME will expect the listed brands of all metals<sup>14</sup> which have not already done so to disclose the efforts they are currently undertaking in respect of responsible sourcing in line with the questions set out in the LME's existing responsible sourcing survey (see Section 4). This information will be provided to the LME on a confidential basis, which will (during the engagement phase) publish aggregate results only. The LME will make every effort to work with relevant listed brands to ensure engagement; however, the LME will consider taking appropriate Brand Action in the event of non-compliance in respect of such disclosure.

Concurrently, the LME will engage with the producers of its listed brands to further understand their timelines and methodology for compliance with the ISO 14001 and OHSAS 18001 / ISO 45001 certifications.

#### 5.4.2. Brand classification

The LME proposes to adopt a risk-based methodology to assess the focus which should apply to its various metals, and the listed brands of each metal.

At the outset, the LME recognises that the risk profile of its metals varies. Utilising the OECD Red Flags as a guide, and based on the LME's understanding of the geographical and other sourcing characteristics of its listed brands, the Exchange believes:

- **Cobalt and tin** may present a higher risk profile, and hence constitute "Automatic Higher-Focus Metals" for the purposes of the LME's responsible sourcing assessment. The consequent impact is that the LME would classify all of its listed cobalt and tin brands as "Higher-Focus Brands", with correspondingly greater diligence required to evidence appropriate responsible sourcing credentials
- **Aluminium and alloys, copper, lead, molybdenum, nickel and zinc** present in aggregate a lower risk profile, and hence constitute "Potentially Higher-Focus Metals" for the purposes of the LME's responsible sourcing assessment. However, the LME recognises that, even within these metals, certain brands may have specific features which would militate for greater diligence as to responsible sourcing practices – and, as such, would expect all brands to undertake an OECD Red Flag assessment, with the results of this assessment (and supporting analysis) to be provided to the LME<sup>15</sup>. While the assessment process would

<sup>14</sup> This applies to physically settled non-ferrous metals only – the LME's ferrous contracts are cash settled, and LMEprecious contracts are settled via the loco London vaulting process

<sup>15</sup> The LME expects that it will be necessary to issue further guidance to the market as to the required parameters for an OECD Red Flag assessment and will work with the market to define such guidance. In particular, it may be desirable to require brands to implement Step 1 of the OECD Guidance (establishing strong company management systems) in order to



be undertaken internally by the producer of the brand, this would be subject to initial and ongoing external review by the LME, which would take into account (among other things) any fabricator or consumer concerns in respect of the given brand

Based on the above logic, brands would then be divided into two groups:

- **Higher-Focus Brands**, i.e. all brands of cobalt and tin, and metals of other brands where the OECD Red Flag assessment raises potential elevated risk factors as to responsible sourcing. As such, these brands will be required to adopt a standard (internal or external) which has been assessed as being aligned with the OECD Guidance, and audit their compliance to that standard. The process for both the alignment assessment and audit process is outlined further below in Section 5.4.3.
- **Lower-Focus Brands**, i.e. brands of metals other than cobalt and tin, where the OECD Red Flag assessment has not raised potential elevated risk factors. These are, therefore, brands considered to be at lower risk in respect of responsible sourcing concerns, and as such, will not be required to undertake formal standards or brands compliance by the LME. However, given the ongoing evolution of the responsible sourcing universe, these brands would be expected to re-assess their classification (via an OECD Red Flag assessment) on an annual basis, as outlined in 5.4.3 below.

As such, brands can expect to become classified via the process outlined in Figure 4 and the LME will work with all its brands to ensure that they are correctly classified. Any brands not engaging with the classification process may be subject to Brand Action.

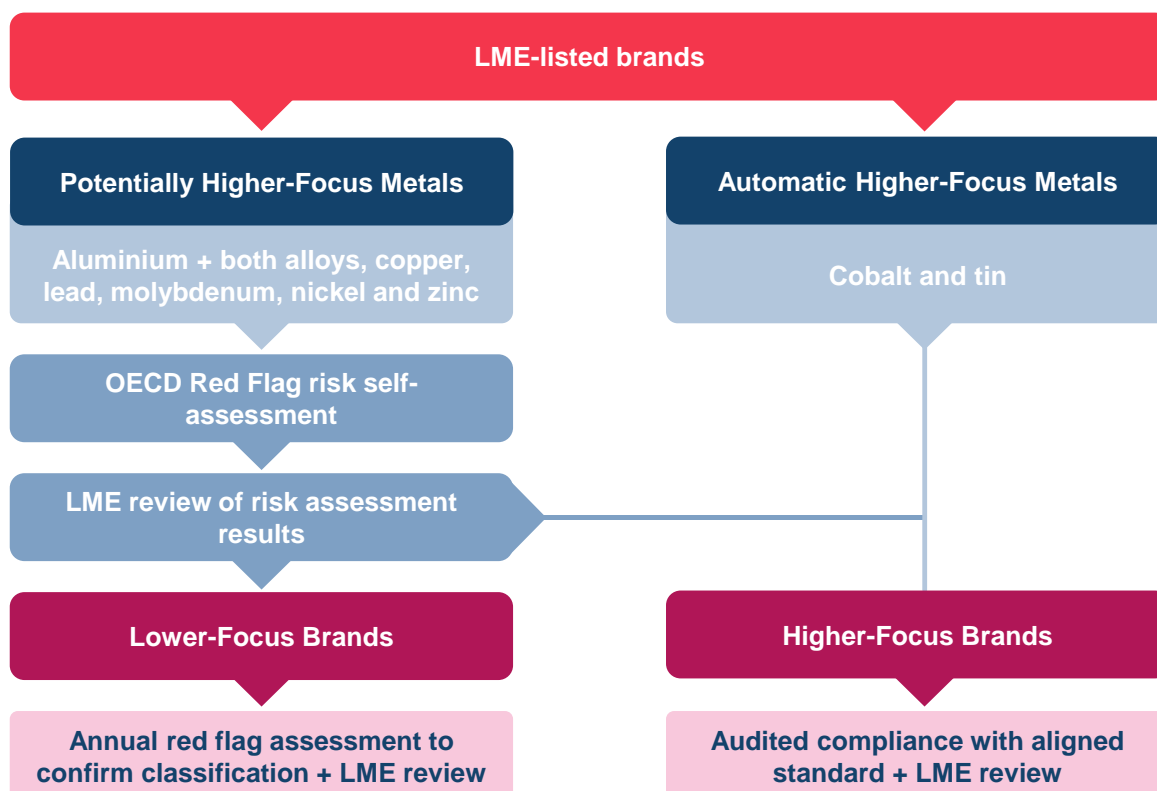


Figure 4: Brand classification process

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undertake a credible Red Flag assessment, and to report on an annual and public basis their efforts in line with Step 5 of the OECD Guidance

Of course, the LME recognises that many brands are already working to mitigate any responsible sourcing concerns associated with their brand – through risk assessment, internal policies or compliance with an external standard – and has designed its proposal with the intention of supporting existing work, rather than necessitating duplication.

### 5.4.3. Brand compliance

As set out above, Lower-Focus Brands will not be required to undertake an audit against a standard. However, all brands confirmed as lower-focus will be required to re-undertake an OECD Red Flag assessment on an annual basis to ensure that their risk profile has not changed over the preceding year, or indeed, that they do not require a reclassification to the higher-risk category. The LME, advised as appropriate, will review all such assessments to confirm its agreement with the resulting classification.

Higher-Focus Brands will be expected to undertake the following steps:

- **Identify a standard.** The producer of a Higher-Focus Brand will need to identify the standard towards which they are working to align their brand. As set out in Section 2.4, standards may be internal or external, and the LME believes that either internal or external standards may be used for the purposes of its responsible sourcing framework
- **Ensure the standard has undergone OECD alignment assessment.** The producer's chosen standard must be aligned with the OECD Guidance<sup>16</sup>. In the case of an external standard, the body owning that standard would be expected to arrange for the relevant alignment assessment. In the case of an internal standard, the producer itself would need to make such arrangements. But in either event, the producer of the relevant brand is responsible for ensuring that it has elected a standard which is successfully OECD alignment assessed<sup>17</sup> and that the results of such confirmation have been approved by the LME. The LME proposes to maintain a list of recognised OECD alignment assessors who, in the opinion of the LME, are competent to undertake an alignment assessment
- **Demonstrate initial compliance with the standard.** The producer's elected standard will specify the requirements for audit, and the producer will hence be expected to comply. In the case of an external standard, the standard itself may lay out a review process, through which the audit will have to pass. In the case of an internal standard, such a review process is unlikely to form part of the standard, and the output of the audit will hence represent the final stage in the process. But in either event, the ultimate decision will need to rest with the LME (advised, where appropriate, by its relevant Committees and potentially other stakeholders)
- **Demonstrate ongoing compliance with the standard.** Again the producer's elected standard will specify the requirements for updating or repeating the audit process, and must be followed to ensure ongoing compliance with the LME's responsible sourcing requirements. Similarly, required audit documents must be submitted to the LME

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<sup>16</sup> As further explained in Section 2.4, it is acknowledged that alignment assessment does not have a "binary" outcome. Ultimately, it will be for the LME (advised, where appropriate, by its relevant Committees) to make the final determination on whether the alignment assessment of a given standard has been successfully undertaken

<sup>17</sup> In the case of an external standard, it is expected that a producer would look for this assurance before pursuing the standard in question. In the case of an internal standard, the producer may look to undertake the alignment assessment in parallel with its implementation work in respect of the standard, acknowledging that any changes to the internal standard arising from the alignment assessment process will also need to be reflected in the implementation workstream

This process is outlined in Figure 5.

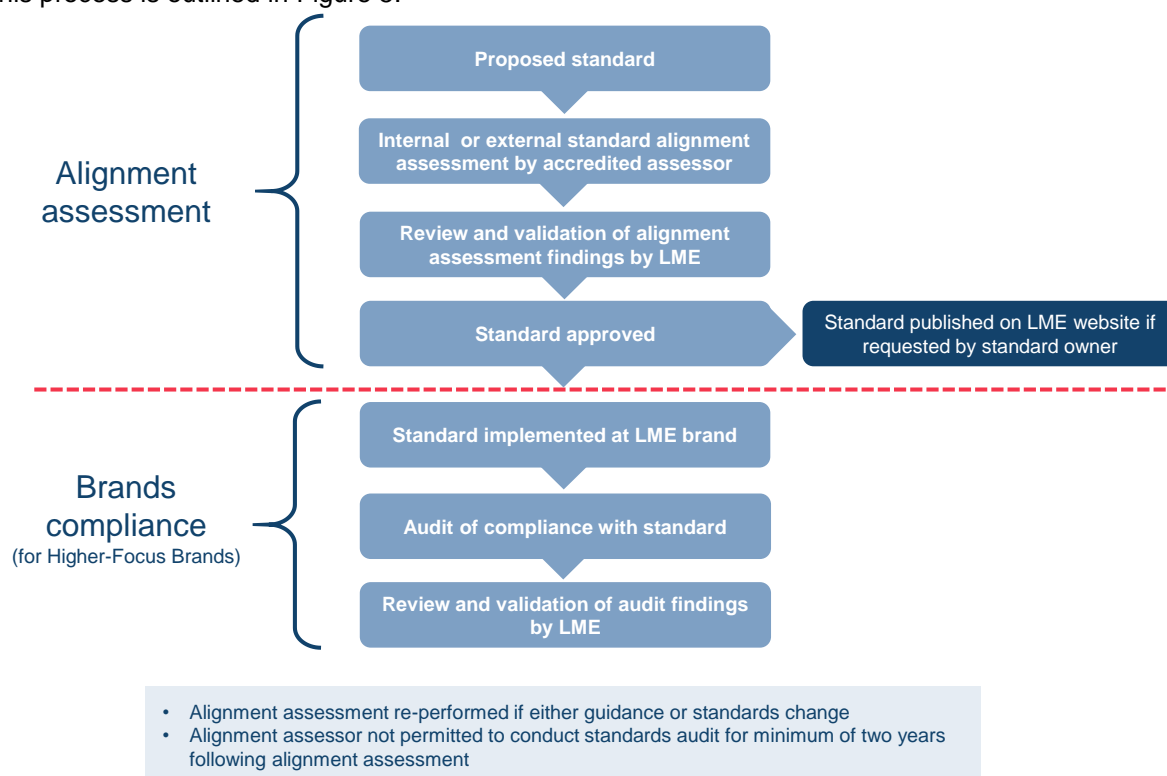


Figure 5: LME process for Higher-Focus Brand compliance

In parallel, all brands will be expected to:

- **Obtain ISO 14001 and OHSAS 18001 / ISO 45001 certifications.** This requirement will be administered in a similar manner to the LME's existing ISO 9001 requirement, in that producers will be required to provide the appropriate certificates

At any stage, a brand failing to undertake required actions (at the times specified by the LME's implementation timeline, as further set out in Section 5.7) may be subject to Brand Action.

## 5.5. Transitional provisions for cobalt

The LME remains conscious of the specific market concerns in respect of cobalt, and the consequently more time-sensitive nature of responsible sourcing requirements for this specific metal. Accordingly, there exists a specific challenge – the LME's timeline for the implementation of its full responsible sourcing standards must necessarily allow time for the alignment assessment of standards, followed by the implementation and audit of those standards by producers. As such, it is not feasible to take action in the short-term (i.e. in the coming months), because it is unlikely that many brands (no matter how strong their responsible sourcing credentials) would be able to demonstrate compliance. Therefore, a different approach must be adopted to provide a more immediate solution.

In this regard, the LME notes that the cobalt market already exhibits a strong focus on responsible sourcing, and consequently, brands which are unable to demonstrate their responsible sourcing credentials tend to trade at a significant discount to those which can. In the physical market, therefore, there already exists a clear economic mechanism by which a failure to embrace responsible sourcing is noted and incorporated into pricing.

For the LME, the challenge is more nuanced. The LME is a “seller’s market”, meaning that – when contracts proceed to physical delivery – the seller can deliver any metal (provided that it is of an LME-listed brand) to the buyer. An economically rational seller, therefore, will deliver metal of the least desirable (and hence cheapest) LME-listed brand. And, because the LME price is discovered on the basis of such deliveries, the LME price will tend to converge to the value of the least valuable brand on the LME. Accordingly, the LME (or, indeed, any exchange market) is not able to differentiate between the various brands on its market, and the presence of a brand with characteristics disliked by the market (including a failure to properly embrace responsible sourcing requirements) will hence result in the LME price falling to reflect the discounted value of this least valuable brand.

Accordingly, and as a transitional provision until the LME’s proposed full responsible sourcing regime has come into effect, the LME is proposing a specific regime for cobalt, which would operate as follows:

- The LME may identify one or more particular LME-listed cobalt brands as “Potential Low-Value Brands”, being a brand which the LME believes is trading at a 2% (or greater) discount to the LME’s other listed cobalt brands. Although discounts may arise for a broad range of reasons, the LME’s understanding is that, at present, the most significant discounts in respect of its listed cobalt brands relate to responsible sourcing concerns. The LME’s determination of brands will be based on the LME’s understanding of the market, but market participants may also suggest to the LME that certain cobalt brands should be assessed as Potential Low-Value Brands
- The LME would make an announcement to the market that the brands had been designated as Potential Low-Value Brands. A 30-day “Objection Period” would then commence, during which market participants (including the producer of the Potential Low-Value Brand) would be able to object to the designation. It would be expected that such objections would be accompanied by evidence – the most obvious example of such evidence being physical transaction records demonstrating that the Potential Low-Value Brand does not, in fact, transact at a material discount in the physical market
- The LME would then reach a final determination, based on objections submitted. If the LME maintains its view, then the brand or brands concerned would be classified as an “Actual Low-Value Brand”, and the LME would be able to take Brand Action

It should be noted, in particular, that this would give the LME the power, in a reasonably short timeframe, to delist (and, indeed, potentially to remove the warrants of) brands which were designed as Actual Low-Value Brands. In addition to the positive impact from a responsible sourcing perspective, such action (if taken) may further have the effect of causing the LME price to rise (all other factors being equal), if stocks of lower value warrants are removed from LME delivery. Market participants are advised to consider the impact of such a development on their LME cobalt trading arrangements.

## **5.6. LME decision-making and grievance procedure**

As noted further in Section 2, a fundamental limitation on the global adoption of responsible sourcing standards is the global nature of metal supply chains, and the consequent lack of a “central authority” with the ability to enforce standards on a worldwide basis. For this reason, in formulating its responsible sourcing proposals, the LME has had to take on a role of assessing compliance, both in respect of the sufficiency of the alignment assessment of standards, and the audit of Higher-Focus

Brands as being compliant with standards. While the LME is comfortable in playing such a role (which it already does in respect of the final assessment of the metallurgical quality of its brands, informed in that case by assaying and other assurance processes), the Exchange recognises also that there will be differing market views on these topics, and it will not always be possible to reach decisions which are accepted by all market actors. However, in the absence of another body willing to undertake such a role (and enjoying the confidence of the market so to do), the LME believes that it will need to act as the ultimate arbiter of these standards.

In reaching its determinations, the LME will have access (as at present) to its Committees, which are composed of industry experts, and provide a strong cross-section of industry views to the Exchange.

Furthermore, and in order to facilitate engagement from as broad a set of stakeholders as possible, the LME does propose a “grievance procedure”, under which any market actor having concerns to the responsible sourcing credentials of a particular brand may report these concerns to the LME, on a confidential basis. Having received a submission of this nature, the LME will assess the stated grievance against the information provided by the brand (including, but not limited to, its OECD Red Flag assessment, and its audit reports if applicable).

## 5.7. Timeline

As set out in Section 5.2, the LME’s proposed timeline is informed both by strong stakeholder focus on this topic, but also the practicalities of delivering a robust and sustainable responsible sourcing framework.

The key points in respect of the pathway to responsible sourcing compliance are as follows:

- **The “Transitional Provision Commencement Date”** (only applicable to cobalt). From this date onwards, the Exchange will be empowered to identify LME-listed cobalt brands trading at a depressed price (due to, amongst other factors, to the market’s concern as to their responsible sourcing credentials), and potentially take Brand Action against such brands
- **The “Responsible Sourcing Disclosure Date”**. By this date, producers of all brands must have informed the LME of their current approach to responsible sourcing requirements, by completing the LME’s producer survey
- **The “Red Flag Assessment Date”**. In respect of Potentially Higher-Focus Metals, this is the date by which producers must have submitted to the LME, for each brand, their OECD Red Flag assessment, including their assessment of whether the brand is a Higher-Focus Brand (i.e. that some or all of the OECD Red Flag indicators have been triggered)
- **The “Standard Identification Date”**. In respect of Higher-Focus Brands, this is the date by which producers must have informed the LME of the standard which they intend to meet (and be audited as such)
- **The “Standard Alignment Assessment Date”**. In respect of Higher-Focus Brands, this is the date by which identified standards must have successfully (in the assessment of the LME) undergone a successful alignment assessment against the OECD Guidance. In the case of external standards, it would be expected that brands would select standards which had already achieved alignment; as such, this date will be more relevant for those producers electing an



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internal standard, and hence taking responsibility for ensuring a successful alignment assessment

- **The “Brand Compliance Date”.** In respect of Higher-Focus Brands, this is the date by which brands must have successfully (in the assessment of the LME) undergone an audit to demonstrate compliance with their nominated (and alignment-assessed) standards
- **The “ISO Compliance Date”.** In respect of all brands, this is the date by which ISO 14001 and OHSAS 18001 / ISO 45001 certifications must be provided to the LME

The proposed dates are set out, on a per-metal basis, in the following timeline:

	Cobalt	Tin	Others
Transitional Provision Commencement Date	3Q19	n/a (only applicable to cobalt)	n/a (only applicable to cobalt)
Responsible Sourcing Disclosure Date	3Q19	3Q19	3Q19
Red Flag Assessment Date	n/a (due to status as Automatic Higher-Focus Metal)	n/a (due to status as Automatic Higher-Focus Metal)	4Q19
Standard Identification Date	4Q19	4Q19	4Q20
Standard Alignment Assessment Date	2Q20	2Q20	2Q21
Brand Compliance Date	4Q20	4Q20	4Q21
ISO Compliance Date	4Q21	4Q21	4Q21

*Figure 6: Proposed LME timeline*

It is acknowledged that customised provisions may need to be put in place for (i) brands which are listed during the timeline, and (ii) brands which are initially not Higher-Focus Brands, but which become Higher-Focus Brands during a subsequent OECD Red Flag assessment. The LME will prescribe timelines for these brands on a case-by-case basis, but consistent with the overall principles of the responsible sourcing initiative.

## 6. FEEDBACK TO THIS POSITION PAPER

The LME is committed to working with all of its producers to understand their plans in respect of responsible sourcing, and to ensure that the LME's work here enables, rather than hinders, further progress. More broadly, the LME welcomes feedback from all stakeholders in its market, and the broader metals industry, as to their responsible sourcing proposals. As such, the LME is proposing a period of market feedback between the publication of this paper and 30 November 2018. The LME requests that any interested parties make contact with the LME at [responsiblesourcing@lme.com](mailto:responsiblesourcing@lme.com) before this date with their feedback on this position paper and the LME's proposed next steps. The LME will remain open and receptive to this market feedback so that it can understand and adjust its thinking where appropriate. Any proposed changes to the LME's responsible sourcing approach and timeline will be communicated to the market following this feedback period.

### 6.1. LME Rulebook

The LME will update Part 7 of the LME Rulebook ("Requirements for the Listing of Brands"), and the Guidance Notes for each metal to reflect the requirements outlined above. These changes will be subject to consultation. The LME will aim to release such consultation in the first quarter of 2019, with due consideration to comments received in respect of this paper. Taking into account required notice periods, this would allow the various LME responsible sourcing requirements to take effect in the third quarter of 2019, per the timeline presented in Section 5.7.

## 7. CONCLUSION

The LME would like to thank all of its stakeholders who have engaged on the topic of responsible sourcing to date, especially its producers who contributed to the 2017 producer survey and continue to provide valuable insight into their ongoing efforts in respect of responsible sourcing, and its metal committees who work with the LME on an ongoing basis to ensure that its brand specifications meet market demand. Furthermore, the LME wishes to express its gratitude to those intragovernmental organisations, trade associations, standards bodies and civil society who have reviewed an earlier draft of this document.

In summary, the LME is committed to supporting the global metals industry in its pathway to compliance with responsible sourcing, and looks forward to continued engagement with the market, such that the Exchange can continue to shape its thinking as this important and complex topic evolves over time.