GIR
Global Investigations Review

NEWS

Gold trade compliance standards are weak, says Mark Pieth

07 October 2019

Gold has profoundly influenced the course of world history, including the conquest of Latin America and the development of the modern banking system. Trading figures are immense. On an average day in August 2019, over 4,000 transactions involving gold with a notional value of over US$36 billion took place between the five members of the London Precious Metals Clearing Limited clearing system alone. In total, approximately 4,500 tons of gold are processed each year worldwide, with most of it – around 3,000 metric tons – newly mined.

Where, in this picture, is the responsibility for making sure that gold today is mined to minimise social and environmental impacts? The surprising answer is nowhere. The reason has something to do with the honest statement in 2016 by Dr Jürgen Heraeus, whose family business owns the high-profile Swiss refinery Argor-Heraeus, that "in this industry it is not possible to refine clean gold."

Arguably the biggest challenges relate to the 20% of the world's gold that is mined by small-scale miners. I have witnessed the effects of some of these personally. Over 5,000 metres high in the Peruvian mining shanty town of La Rinconada, men and women amalgamate gold with their bare hands using mercury before burning the highly toxic element off into the air. Over 4,000 Peruvian and Bolivian women are estimated to have been forced into prostitution in La Rinconada alone, and the miners work under an informal labour system known as cachorreo – 27 or 28 days per month without pay in order to be granted a couple of days to mine for gold for themselves. Conditions have not changed much since the days of the Incas and the Spanish conquistadores.

Child labour and conflict are other major risks in small-scale mining; estimates suggest that one million children are working in mines worldwide. The Democratic Republic of the Congo and Sudan offer sobering examples of how gold fuels conflict in war-torn areas, with official armies and rebel groups financing their war efforts with looted gold.

Confronted by these human rights and environmental challenges, some companies in the gold supply chain – such as Swiss gold refinery Metalor– have opted for a risk-averse approach by imposing a blanket ban on all gold from small-scale mines. Yet if refineries and other players further down the supply chain believe that using gold mined only by giant multinational industrial companies will keep them out of trouble, they are wrong.

Large mines are vulnerable to major environmental problems such as the pollution of drinking water, the production of thousands of tons of waste making the landscape uninhabitable, and the creation of "acid mine drainage" – when disused underground mines flood and release contaminated water into rivers and farmland.

Social problems add to the environmental ones. Central governments often hand out mining licences for huge concessions covering the traditional farmland of indigenous communities. These licences may be acquired through corruption: there is clearly a nexus between companies, including multinational mining enterprises, trying to obtain licences at any cost and local elites ready to sell the riches of their country for private gain. Conflicts between mining companies, authorities and private security on the one hand, and the local population on the other, are likely to result in serious violations of the human rights of indigenous populations – as at North Mara mine in Tanzania, operated by London-based Acacia Mining, which is majority owned by Canadian gold-mining giant Barrick (Acacia and Barrick deny responsibility).

Corruption is not the only reason why commodity-rich countries such as the DRC, Nigeria or Venezuela frequently end up with poverty-stricken populations. The so-called resource curse is also a consequence of profit-shifting from the location where the value is generated to low-tax jurisdictions and offshore financial centres.

Sourcing only from industrial mines, therefore, allows gold refineries and traders to tick the compliance box and pass some perfunctory audits, but it does nothing to mitigate the risks of social and environmental abuses. Moreover, it promises to destroy the livelihoods of the 13 million small miners – and the estimated 100 million or so individuals in total – who rely on the industry.
I describe all this because a major function of the law is to protect vulnerable people in all countries from abuses by more powerful players. Where there are competing interests at stake, people are at risk and it is clear that only binding regulations, enforced consistently and internationally, are strong enough to afford proper protection.

The main instrument governing the global gold trade is the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas. Adopted in 2011, the guidance was sparked by the final report of the United Nations Group of Experts on the Democratic Republic of the Congo, which documented how mining of gold and other precious metals had fuelled conflict and human rights abuses in eastern Congo during the country's protracted civil wars.

Annex I of the guidance recommends a sensible and practical five-step framework for risk-based due diligence throughout the mineral supply chain:

1. Establish strong company management systems.

2. Identify and assess risk in the supply chain.

3. Design and implement a strategy to respond to identified risks.

4. Carry out an independent third-party audit of supply chain due diligence at identified points in the supply chain.

5. Report on supply chain due diligence.

The guidance was followed a year later by the OECD's Gold Supplement, which translates the five-step framework into great detail for each level of the gold supply chain and describes red flags for enhanced risk assessment.

Together, the two documents represent the global standard on responsible sourcing of minerals, including gold. But they are not legally binding.

"Regulation" of the gold trade is currently left to a cluster of trade associations, namely the London Bullion Market Association, Responsible Jewellery Council, World Gold Council and Dubai Multi Commodities Centre. The associations have all developed their own sets of industry standards based loosely on the OECD texts, but with some major weaknesses.

In brief, the industry standards mainly focus on providing assurance to downstream clients and stakeholders. They do not compel refineries, or other companies dealing in gold, to conduct comprehensive due diligence upstream along the chain of suppliers to where the human rights abuses and environmental damage take place. Audits, where they are performed, are little more than an exercise in paperwork, and transparency is severely lacking.

For me, a fundamental question is: how can an association set up to promote the gold trade be credible in also supervising it?

The US at one point seemed to be leading efforts to introduce more transparency into the minerals supply chain. Section 1502 of the Dodd-Frank Act obliged US companies dealing in potential conflict minerals to implement a compliance programme and file reports on their compliance efforts to the Securities and Exchange Commission each year. Key parts of the Dodd-Frank Act, including section 1502, have unfortunately since been repealed by the Trump administration.

The Conflict Minerals Regulation, when it comes into force in 2021, is a noteworthy attempt to translate the OECD Due Diligence guidance into European law. EU importers will be subject to detailed reporting obligations and the European Commission will maintain a list of "global responsible smelters and refiners". Furthermore, member states must designate competent authorities to carry out "appropriate ex-post checks".

As long as it is properly enforced, the EU's Conflict Minerals Regulation will show that mandatory regulation and supervision by public entities of due diligence requirements in the mineral supply chain is perfectly possible. It is, however, the only example of hard law in this area and it only applies to EU countries. The other international standards are voluntary, and there is nothing to compel major gold-refining countries – Switzerland, the US and the UAE – to conduct proper due diligence on the source of their gold or to report on it.

Across the world, well-meaning individuals and organisations are attempting to supplement this soft-law picture to help clean up the dirtiest parts of the gold supply chain. Certification for fairly mined gold, such as the Fairtrade or Fairmined labels, can help raise standards and salaries for small-scale miners. In my home country of Switzerland, there are efforts to help small-scale mines access global markets directly to avoid being exploited by middle-men.

Laudable as they are, these initiatives have a marginal effect and are implemented patchily across the world.

So, who is responsible for mitigating the social and environmental risks in the gold supply chain and answering to abuses in a court of law? I place a lot of responsibility on the gold refineries as the point where the gold is "laundered" and loses the traces of its problematic past. The refineries, I argue, are the gatekeepers to the nice world of clean gold – the world of jewelry, big finance and reserve banks.

Yet it is also true that without binding international laws making supply chain due diligence mandatory right back to the source of the gold, and without transparency and strong reporting requirements, the refineries are gatekeepers without any gates.

Mark Pieth is Professor of Criminal Law at the University of Basel and author of a new book, Gold Laundering: The dirty secrets of the gold trade – and how to clean up.

This article is part of a series of articles provided exclusively to GIR by members of the International Academy of Financial Crime Litigators, a collaboration between public- and private-litigation professionals and the Basel Institute on Governance to expand worldwide access to solutions in cases of economic crime.

First published on the *Global Investigations Review* website, 07 October 2019.

THESE ARTICLES ARE PART OF A SERIES

provided exclusively to **GIR** by members of the *International Academy of Financial Crime Litigators.*

THE INTERNATIONAL ACADEMY
OF FINANCIAL CRIME LITIGATORS