Applying Commonly Used 18 USC 208 Exemptions

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Patrick Shepherd: Excellent.

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Thanks very much Good afternoon and welcome to the Ethics Fundamentals Series.

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My name’s Patrick Shepherd. We’re very pleased to join you today. We’re going to discuss applying commonly used exemptions at 5 C.F.R part 2640, and

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we are very, very fortunate to be joined today by Cheryl Kane-Piasecki, who is going to help us with that discussion. Cheryl Kane-Piaseck: Yes, I certainly am.

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Patrick Shepherd: So I think we have a lot to cover here. Cheryl Kane-Piasecki: We do have a lot to cover. Patrick Shepherd: So we’re just going to go ahead and get into the deck, and get started.

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We will have a question and answer at the end. If we have time, we can cover a few administrative announcements as well.

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Cheryl Kane-Piasecki: Okay. Very good. In the materials you were sent, you should’ve been sent the deck, which obviously we’re

**Resources**

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going to pull up here in a second, we should have showing right now, and we also gave you a separate handout that had the exercises that we’re going to be walking through today

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on it. So if you want to have that sort of separate and apart so that you can take notes based on the conversation Patrick and I are going to have about each of those scenarios in just

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a bit. In addition, we gave you some handouts, and we’ll be making reference to those other

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resource documents, legal advisories, etcetera, as we go through the broadcast. We’re going to start with a very brief overview of 18 U.S.C.

**Section 208 Overview**

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section 208. Our presumption was that everybody has this kind of under their belts, but just a really

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quick and dirty kind of review of 208 so that we can get into the 2640 exemptions because as you all are aware, the exemptions are exemptions to this criminal statute, and if you are not

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familiar with the statute then the exemptions are obviously not very meaningful to you.

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So just really quick, 18 U.S.C. section 208 is a prohibition on an employee’s participation in a particular government matter

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if the outcome of that matter would have a direct and predictable effect on the employee’s

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financial interests, including the financial interests or certain others, including their spouse or minor children, but those interests are attributed to the federal employee.

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So the overarching purpose of 208 is to prevent an employee’s personal interests from influencing

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their government decisions, and we do that by not allowing them to participate. So it’s a participatory bar. Patrick Shepherd: Right, and the exemptions we’re going to discuss are exemptions to

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this law. Cheryl Kane-Piasecki: Yes. Patrick Shepherd: Even though we find them in a regulation, it’s important for us to remember that they’re exemptions to a criminal statute.

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So we want to be careful. Cheryl Kane-Piasecki: Yes, and the authority for us to issue those exemptions is in that statute itself.

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Patrick Shepherd: Right. Cheryl Kane-Piasecki: Okay. There is a common misconception that there’s a government-wide restriction on holding certain

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assets, and that is not true. 208 is not a restriction on holding anything. 208 reaches to your participation in the matter, not to any particular interests that you might

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hold that could be affected by a government matter.

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So on the next slide, we just want to show that a 208 analysis, a conflict of interest analysis is effectively, you’re looking at a nexus, so you just want to see whether

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or not there is a nexus between a particular government matter that an employee has been assigned to, an any financial holdings or any other financial interest that they have

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that could be affected by the outcome of that matter. If you don’t have a nexus between a government matter and the financial holding or other

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interest, you simply don’t have a 208 conflict of interest. Patrick Shepherd: And this is a process that should be familiar to anyone who reviews financial

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disclosure reports, and I think it’s important for us to remember also that this law applies equally to all employees of the federal government, not just our financial disclosure filers,

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so we can see this in other places as well. Cheryl Kane-Piasecki: Exactly. So in the next slide, we basically, when we’re talking about remediation, remedying up a

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potential conflict or an actual conflict, which is what the 2640 exemptions are one of the remedies for a 208 conflict.

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There are basically two ways that you can remedy a conflict, because you have two pieces that have to be there in order for a conflict to exist.

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So you can either remediate the conflict by removing the employee from the matter, or

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by removing the disqualifying financial interest in the matter. So we’ve just give you a couple of visuals of this.

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So in the next we’re basically just showing you that what a recusal does, is a recusal is handling the particular matter half of that nexus.

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A recusal removes the person, so it removes that matter from the nexus with the individual’s

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personal financial holding or other interests. So once you’ve eliminated the nexus by not having the person participating in the matter,

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that is the primary way, and kind of the default way to remediate a conflict, but that’s just one of several ways that you can remediate a conflict.

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Patrick Shepherd: So this, in sort of simple terms, if I’m asked to participate in a matter that has the potential to affect my financial holdings, the thing that I should

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do is not participate. Cheryl Kane-Piasecki: Precisely, precisely. Patrick Shepherd: Or just stop. Okay.

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Cheryl Kane-Piasecki: And that’s really the key to tell employees, that if they believe at any point in time they have a financial interest in a matter to which they’ve been

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assigned, their first course of action should be not to participate, unless or until some other remediation can be arrived at, and the other remediation is what the next slide’s

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going to be dealing with. So the other way that you can remediate a conflict is by somehow handling or taking

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care of or getting rid of the financial interest in the matter, and we can do that through a variety of ways, and it really depends upon what the nature of that thing is that gives

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the person the financial interest in the matter. If it’s something that is subject to divestiture, divestiture is one way that you can do it.

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We have written waivers that are available under 208(b)(1), we’re not going to be dealing with those today, but then we also have the 2640 exemptions which the authority for which

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is found in 208(b)(2). 2640 is a reference to the 5 C.F.R.

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part 2640 regulations where those exemptions are housed. Patrick Shepherd: So after I’ve identified that I have a potential conflict of interest

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or I’ve been asked to work on something that might affect my financial holdings, the first thing I want to do is not work on that.

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Cheryl Kane-Piasecki: Yes. Patrick Shepherd: And then I might look to another possibility. Say it’s important for me to work on that, I may qualify for one of the exemptions we’re

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going to discuss today, I may be issued a waiver by an appropriate authority at my agency,

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or I may sell that conflicting holding. These are all sort of the possibilities. Cheryl Kane-Piasecki: Exactly. So again, just another visual representation of what we just talked about is the second

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way to remediate the conflict is to take away the financial interest part of that nexus

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in the matter. So that would allow the employee to continue to participate in the matter because they would no longer have a financial interest in the outcome of that matter.

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Patrick Shepherd: Okay. Cheryl Kane-Piasecki: So a few words about the 2640 exemptions that we’re going to

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focusing on today, just kind of as a general proposition, only OGE is authorized to issue

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exemptions, and that doesn’t mean that we haven’t and can’t issue exemptions that are tailored to specific needs of specific agencies, it’s just that agencies themselves

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do not have the authority to issue exemptions to the criminal statute 18 U.S.C.

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section 208. These regulations, the exemptions are housed, as I said before, in 5 C.F.R.

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part 2640. They apply automatically, and by that we mean unless you have a separate statutory authority

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that gives you the ability to prohibit, for example, certain types of financial holdings,

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or unless you have issued a supplemental regulation that is going to, for example, prohibit your

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employees from holding certain financial holdings, the exemptions in 2640 apply automatically.

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They are not discretionary. Patrick Shepherd: Okay. Cheryl Kane-Piasecki: And then finally, what the 2640 exemptions do, is they not only mitigate

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or eliminate the 208 conflict of interest, but they also take care of any residual appearance

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concerns under the impartiality provision. Patrick shepherd: And I think, you know, when we’re looking at this, the big thing to take away is to remember that 2640 is about implementing the criminal law, 18 U.S.C.

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section 208. Cheryl Kane-Piasecki: Right. Patrick Shepherd: The exemptions apply only to 18 U.S.C. section 208. Cheryl Kane-Piasecki: Right.

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Patrick Shepherd: So if you’re dealing with a problem under some other authority, 2640 isn’t going to help you because it’s only for 18 U.S.C.

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section 208, and if you kind of remember that, you’ll avoid some difficulties.

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Cheryl Kane-Piasecki: Yes. So our agenda for today is we’re going to be introducing a process for determining if

**Agenda**

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certain of the 2640 exemptions apply, and we’re going to be talking about the most commonly used, or the most commonly encountered 2640 exemptions which are those for mutual

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funds and unit investment trusts, publicly traded securities, and employee benefit plans. We’re going to apply that process to some specific examples.

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We’ve given you those exercises in advance, and then we’re also, in the process, going to be trying to show you some resources that you can use to assist you in engaging in that

**Analysis Processes**

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analysis. In the next slide, with the analysis processes effectively, you have to first determine,

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before you even get to the 2640 exemptions, you have to first determine that 208 even applies.

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So your first question has to be, will the outcome of the government matter to which the employee has been assigned have an effect on an identified interest that the employee

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holds. Patrick Shepherd: Right. So if we don’t have a problem under 208, we don’t need an exemption to 208. Cheryl Kane-Piasecki: Exactly. Once we’ve determined that there is a potential conflict of interest or an actual conflict

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of interest under 18 U.S.C. section 208, then we have to ask ourselves, well okay, is there a potentially an exemption

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under 2640 that would basically take care of this type of interest that the employee

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has in this particular type of matter. Patrick Shepherd: Okay. Cheryl Kane-Piasecki: We want to make sure that the exemption that we’re going to rely

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on actually covers the type of financial holding, or the type of thing that the person has.

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As we said, there are a variety of different instruments and different types of financial interests that someone can have in a matter that are covered by different exemptions.

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So we want to make sure if we look at an exemption that we’re making sure that that exemption actually covers the type of financial interest this person has.

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Patrick Shepherd: So where we see that there’s a nexus between a particular matter and a financial holding, if we’re going to use an exemption the thing we have to figure out

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is, is the exemption appropriate for that holding? Cheryl Kane-Piasecki: Right. Patrick Shepherd: Is the exemption sufficiently broad or sufficiently targeted to cover that

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thing? Cheryl Kane-Piasecki: Yes, and then likewise, as we’re going to talk about, these various

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exemptions cover different types of actual government matters. So, you know, you not only have to make sure that the financial holding is amenable to

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that exemption, but then you also have to make sure your, the exemption covers the type of matter that you’re anticipating the employee would be working on that gives them the conflict

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of interest. Patrick Shepherd: So these exemptions are limited both in the kinds of holdings that they cover, as well as the kinds of particular matters that they’re available for.

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Cheryl Kane-Piasecki: Right. Patrick Shepherd: So we have to be careful on both sides of that equation when we’re looking at these. Cheryl Kane-Piasecki: And typically what we’re talking about when we say type of particular

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matter, we don’t have to be all smoke and mirrors here, I mean the type of particular matter, we’re basically saying, is it a specific party matter or is it a matter of

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general applicability? For the most part our exemptions are going to cover one or both, one or the other, or

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both of those. Patrick Shepherd: And those are specific party matters. Those are the matters where we have named parties, so things like contracts, grants,

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licensing, investigations, particular matters of general applicability are those broader matters that affect a discrete and identifiable class, like maybe a rule making, or a policy,

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or that kind of thing, sort of broader things where you don’t have any parties. Cheryl Kane-Piasecki: Right. Patrick Shepherd: I think something else about 2640 that I find helpful is a lot of these

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definitions are in the regulation. Cheryl Kane-Piasecki: Yes. Patrick Shepherd: So rely heavily on the definitions, if you’re not sure what something is, there’s

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a good chance that it’s described in some detail in the definition section. Cheryl Kane-Piasecki: Yeah, and when we get into the exercises you’re going to see precisely

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what we mean by that, and in order to determine whether some of these exemptions apply, you’re going to have to use the definitions section.

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The next part of the analysis process is, certain of the exemptions have dollar values

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that have to be met, de minimus thresholds, so it’s a matter of discerning whether or not the person’s holdings meet those thresholds, and then if there are any other aspects of

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the exemption, any other criteria, any other definitions that need to be met to make sure all the other elements of the exemption are met.

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Patrick Shepherd: And I think, you know, this is kind of a lengthy process, and I think it’s lengthy because these exemptions are specific.

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Cheryl Kane-Piasecki: Yes. Patrick Shepherd: They’re not kind of rules of thumb or broad things that you can sort

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of keep in mind, they’re really specific. Hey have specific elements that have to be met before we can apply them.

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Cheryl Kane-Piasecki: Very good, and apply them we are going to do. So we’re going to start with the mutual funds and unit investment trusts, sort of

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talking about that, and so we’re going to immediately jump in by looking at our first exercise, because the best to learn and to get familiar with these regulations is by

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actually applying them in context, applying them to a set of facts. So our first exercise is this, you have a CIO who is working on various contracts for

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IT hardware, software, and services, and they have the following portfolio.

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They have two hundred thousand dollars in Wells Fargo Advantage Endeavor Select Fund, they have twelve thousand in Vanguard Information Technology Index, and they have sixty-five

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thousand dollars in iShares US industrials. So when we’re using our process, the first thing we want to ask ourselves is will the

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outcome of the matter affect the holding. In other words, do we think we even have a potential 208 conflict of interest here?

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And I think, Patrick, when we look at this, when you see that we’ve got contracts for

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IT Hardware, Software, and Services, we’ve got a CIO. Patrick Shepherd: Right. Cheryl Kane-Piasecki: So anything that’s touching information, technology is basically

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going to be something in their wheel house. Now we’re looking at what appear to be pulled investment vehicles.

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Why should we be concerned about a pulled investment vehicle? Patrick Shepherd: Because those pulled investment vehicles hold or contain companies.

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Specific holdings or specific financial things that could pose a potential for a conflict

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of interest for us possibly. Cheryl Kane-Piasecki: And I think that, I mean I would assume that since information/technology

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is an area that is a goodly part of our economy, that the likelihood that many mutual funds

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would have at least one holding that was in some sort of IT related thing is probably

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pretty high. Patrick Shepherd: I think so. I think we look at the financial press or even just the normal press, we see a lot of

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discussion about technology holdings, technology stocks, technology companies, and sort of

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all across our economy now we see a lot of that. So you know, we might have some overlap here. Cheryl Kane-Piasecki: Right. Exactly.

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So when we think about, okay, so we think there is a real likelihood for a potential for conflicts of interest because the outcome of the matters that they would be working

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on, I mean that the holdings that they have are likely to contain IT related types of financial holdings.

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So when we look at which exemption might apply, I mean we’ve sort of given it away because we’ve said we’re going to start out by looking at the exemptions for mutual funds

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and unit investment trusts, because those are pulled investment vehicles. Patrick Shepherd: Right, and I think, you know, it makes sense that we have an exemption

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here, because as we were juts discussing, for someone like our CIO, the presence of

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technology stocks, they’re going to be in virtually every possible pulled investment vehicles, you’re not going to find many funds that don’t touch technology in some

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way. Cheryl Kane-Piasecki: Right. Patrick Shepherd: So we’d have a situation where to be a CIO in the government, you’d be very constrained in the kinds of things you could hold.

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Cheryl Kane-Piasecki: Right. Patrick Shepherd: SO I guess that what we’re going to be looking at here. Cheryl Kane-Piasecki: Yes, that’s exactly what we’re going to be looking at, but this

**Definitions**

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is where, when we said you need to get familiar with the definitions, we mean it. You really need to get familiar with the definitions, because the first thing we have to determine

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is whether or not any of the things that our person holds, that we think are pulled investment vehicles, are actually qualified as a mutual fund for purposes of the 2640 exemptions,

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and here, if we look at the defintion, we’ve given you the definition on the screen here, but you should become familiar with where it’s located in the 2640 regs, which is

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at 102k in the definition section, and the mutual fund for purposes of our regulation,

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for purposes of these exemptions means an entity which is registered as a management

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company under the investment company act of 1940. For purposes of this part, the \*\*\* mutual fund includes open end and closed end mutual

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funds and registered money market funds, Patrick Shepherd: So we’re not just talking about any pulled investment fund. Cheryl Kane-Piasecki: Right.

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Patrick Shepherd: It’s got to be a mutual fund. Cheryl Kane-Piasecki: It has to be a mutual fund that is a mutual fund that is registered

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under the investment company act of 1940. There are other investment company acts of different differing years.

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The mutual fund definition we use means the entity has to be registered under the investment

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company act of 1940. Patrick Shepherd: Okay. Cheryl Kane-Piasecki: So why don’t we take a look, I’ve just given you a screenshot

**Fund Filings**

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here. Typically we would go out to the net and actually walk you through this, but just for the sake of time because we’ve got a lot of material to cover, I’ve just given you a screenshot.

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This is the first of the pulled investments that we saw that our employee had, which is Wells Fargo Advantage Endeavor, and there are a couple of things I want to point out

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about this. One is that there is a ticker symbol for it, and it’s STAEX, and we’re going to see

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some similarities among ticker symbols, among mutual funds, so that’s just kind of a,

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and we’re going to talk about that in a second, but just kind of pay attention to that. But in addition to that, there’s a description of the fund and below that there is a pdf

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with the fund filings. What do we mean by fund filings? What does that mean Patrick? Patrick Shepherd: So these are the documents that the funds have to provide to the Securities

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and Exchange Commission periodically, reporting on earnings, registrations, name changes, things like that.

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Cheryl Kane-Piasecki: Now it’s in those fund filings where you’re going to find whether or not this is registered under the investment company act of 1940.

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So if you see something and you’re not sure whether or not it is actually a mutual fund, you can go to the fund filings, you can pull up one of their filings, and if you do, what

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is it, Patrick Shepherd: control f Cheryl Kane-Piasecki: a control f for, Patrick Shepherd: And I just put 1940. Cheryl Kane-Piasecki: And you can just put 21940 in there, and it should pull up for

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you whether or not this particular fund is part of the investment company act of 1940.

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Patrick Shepherd: In my experience almost all of these filings are filed pursuant to

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the requirements of act. So in many, many cases you do that control f for 1940 and you say, you know, the filing

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itself will say, pursuant to the requirements of the investment company act of 1940 we’re furnishing the following information, or in a footnote somewhere it will say, we are subject

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to the act. It’s usually pretty easy to discern whether or not they are covered by the act, reading

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almost any of the filings. Cheryl Kane-Piasecki: Okay. So that’s just a heads up of that’s where you can get that information if you’re saying,

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“how the heck and I supposed to know if it’s part of the Investment Company Act of 1940?” Well you can find it, and as I said again, there’s a ticker symbol that we’re going

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to pay attention to too. So if we look at the next one, this was Vanguard Technology Information Index, which is the

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other fund that this individual had, and if we look at the ticker there, it seems to indicate

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that it’s calling itself a mutual fund. Patrick Shepherd: Right. Cheryl Kane-Piasecki: And it has a ticker symbol again that’s a five letter ticker

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symbol with the last letter being x, and why do I keep pointing that out Patrick?

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Patrick Shepherd: Because usually if you have a five letter symbol ending in x, you’re

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talking about a mutual fund. The SEC isn’t loosey goosey with who can call themselves mutual funds.

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To call yourself a mutual fund, you usually have to be a mutual fund to have a ticker symbol that looks like a mutual fund you usually have to be a mutual fund.

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So this is a really good hint. If you can find the fund, and you can find the ticker symbol, and it looks like one of

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these, there’s a very, very, very strong likelihood that the exemption is going to

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be available to you. Cheryl Kane-Piasecki: And so for these first two holdings that our person has, they are

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in fact mutual funds. They are both registered under the Company Investment Act of 1940, but this is a clue

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to, is it 100% fool proof, maybe not, but it’s a pretty strong indicator that you’ve

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got a mutual fund. But what about our other holding, which was the iShares, US industrials?

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Patrick Shepherd: So that’s not five letters. Cheryl Kane-Piasecki: That’s not five letters, that’s only three letters.

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It’s IYJ. Patrick Shepherd: Yeah, and that looks like a, that looks like a stock ticker symbol actually.

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We have an indication of the market we’re trading on, but iShares US industrials, that’s

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not sort of a company name I’m familiar with. It sort of looks like a fund and kind of also looks like a stock.

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Cheryl Kane-Piasecki: Right, right. Well iShares is the biggest trader of,

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Patrick Shepherd: Exchange traded funds. Cheryl Kane-Piasecki: Exchange traded funds in the country I think. Patrick Shepherd: Yeah, maybe in the world, but they’re exchange traded funds, so it

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has a ticker symbol that looks like things that trade on exchanges, and indeed, they

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do trade on exchanges. Cheryl Kane-Piasecki: Okay, so the question then is, okay, so it’s an exchange traded

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fund, it’s got a ticker symbol that makes it look like it’s a security and not a mutual fund.

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So what have we said about exchange traded funds, and this is effectively what we’ve said about exchange traded funds.

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Patrick Shepherd: Basically they’re funds. We treat them like mutual funds, the only distinction between these and mutual funds

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is the way they trade. So they trade on intraday exchanges, they have minute by minute prices rather than trading

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only at the close of a session. Otherwise, they’re just the same, so we extend the availability of exemptions to them.

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Cheryl Kane-Piasecki: So we treat them as if they were mutual funds because they are registered under the same statutory authorities as traditional mutual funds, so we believe

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yes, they do qualify for the exemptions in part 2640 that as mutual funds or unit investment

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trusts. Okay, now there are some ETFs that you have to be mindful of, because not all ETFs are

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created equal, okay. So many ETFs are going to be subject to the mutual fund exemptions because they are under

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the investment company act, yes, but there are some, and really the critical ones are

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ones that are either invested in commodities, or commodities futures.

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If you see an exchange trade in fund that’s invested in commodities or commodities futures, they do not meet the definition of mutual fund or unit investment trusts, so they are

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not, the mutual fund exemptions are not available for these.

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Commodities are registered under the Securities Act of 1933, and commodities futures are under

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a different act altogether. Patrick Shepherd: Right, and I think people get worried about this, and the thing that

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I like to keep in mind, is something you said at the very beginning of the presentation, which is that you have to have a possible 208 nexus in order to need an exemption.

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Cheryl Kane-Piasecki: Right. Patrick Shepherd: And for the majority of at least our financial disclosure filers,

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commodities futures and commodities, maybe you know if you work at the Department of Agriculture you may have concerns, if you work at the commodities futures trading commissions

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you might have some concerns, but for use of a general procurement official or investigator, you know moving a commodities index is not going to pose a conflict of interest for a

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whole lot of people. So if you see that people have, an employee has a commodities ETF, the first question

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to ask yourself is that possibly a conflict. Cheryl Kane-Piasecki: Right. Patrick Shepherd: And only when you answer that question in the affirmative do you need to panic about the registration of the fund.

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Cheryl Kane-Piasecki: Right, right. We always have to start with, do we have a conflict, and then we worry about whether or not we have an exemption as a remediating thing for the conflict.

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Patrick Shepherd: Right, so simply because the exemption isn’t available doesn’t always mean commodities ETFs are bad.

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Cheryl Kane-Piasecki: Right. Patrick Shepherd: Or something like that. It just means that if you have a potential conflict this exemption’s not available.

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Cheryl Kane-Piasecki: Exactly. Okay, so is it a mutual fund? The question is, I don’t know why I’m missing this, oh there we go.

**Mutual Funds**

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All three of the things that our CIO holds qualify as mutual funds. So that’s just the first check the box.

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Are they mutual funds? Yes. So could those exemptions be available for these, yes.

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So now we have to ask ourselves, is it a diversified fund or a sector fund?

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And the reason we need to know that is we have two separate exemptions for mutual funds. One for those that are considered to be diversified, and one for those that are considered to be

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sector. And Patrick, what is the definition of diversified, because we have a definition for that too. Patrick Shepherd: Yeah, and I think, you know, this is really important to remember, because

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you can really get wound around the axle thinking about percentages or numbers.

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What we do is, we don’t ask you to go look at all the holdings or funds, there could be hundreds of companies. What we do ask you to do is, go look at the stated investment policy, and if a fund has

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a stated policy of focusing in an industry, business, single country other than the US, or bonds of a single state within the United States, it’s a sector mutual fund.

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If they don’t have such a stated policy, it’s diversified. Cheryl Kane-Piasecki: Yes, and do not trust language that you see, for example, on a webpage,

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like the first one that I showed you that had a description of the fund on it, sometimes you’ll see things like, this is a non-diversified fund or whatever, that they’re using vocabulary

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that exists for other purposes, they’re not using vocabulary or definitions that meet

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our 2640 definitions. So you need to look at the policy and see whether or not the stated policy is that of

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concentrating investments in an industry, a business, or a single country other than

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the United States, or bonds of a single state. So let’s take a look at, oh, one quick thing I want to talk about and sort of touch and

**Mutual Funds vs Excepted Investment Funds**

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go on this is, before we get into looking at each of those discrete things our filer

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has, just a general statement about trying not to conflate the concept of diversified

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mutual fund with the concept of accepted investment fund, because they are two separate concepts,

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one is a conflict of interest concept that is attendant to the exceptions that we use

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for section 18 U.S.C. sectionn208, the other accepted investment fund is a financial disclosure concept only.

26:55

It only reaches to whether or not the holdings of a fund are reportable on your public financial

27:04

disclosure report. Patrick Shepherd: Right. So this is another case where, when we’re in 2640 we’re dealing with 18 U.S.C.

27:11

section 208. There is no other place where we find exemptions to 18 U.S.C. section 208.

27:16

When we’re over in 2634, we’re talking about what has to go on a financial disclosure report.

27:21

Those are two separate matters that actually have very little to with each other. So if you’re trying to decide if an exemption applies, use the definitions in 2640.

27:30

Cheryl Kane-Piasecki: Yes, so just, and I really recommend to folks, you know, print out this slide, because it does give you a nice breakdown of the differentiation between

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the two concepts, and sort of what you need to be focusing on as sort of a quick and dandy

27:45

job aid. So I just recommend just print it out, and if you have any confusion about it, you know,

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your desk officers can certainly help walk you through the distinction between the two concepts.

**Wells Fargo Advantage Fund**

27:56

So let’s look at our Wells Fargo Advantage Endeavor select fund that was the first fund we looked at, and we have a fund summary here.

28:03

And then, looking at the fund summary, Patrick, is there anything there that makes you feel like you can sort of get a sensibility about this fund.

28:11

Patrick Shepherd: Yeah, and I think this is the best place to start when we’re trying to determine if something is diversified, and I see words in here that make me feel

28:20

pretty good, kind of warm and fuzzy that we’re going to get to diversification. We seek long term capital appreciation, that doesn’t sound like we focus on computer

28:31

hardware. Cheryl Kane-Piasecki: Right. Patrick Shepherd: Right, that sounds like our goals are to make money in a certain way,

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we invest our assets in equities, securities, and some foreign securities and AVRs.

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So we buy stocks. That’s not a single industry within the economy.

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We said we’re in multiple countries, so that seems diversified-ish, and it looks like

29:01

it principally invests in the equity securities of approximately 30-40 that offer potential for capital growth.

29:06

Capital growth, also not an industry. Cheryl Kane-Piasecki: Right. Patrick Shepherd: Right, so what we have here are, is a stated policy of reaching financial

29:13

objectives Cheryl Kane-Piasecki: Right. Patrick Shepherd: in a particular way. We’re looking for capital growth, and usually when you see those things, capital growth,

29:21

income, capital appreciation, those kinds of things, we’re looking at diversified

29:27

funds. Cheryl Kane-Piasecki: Right, right. So let’s take a look at the next one which is Vanguard Information Technology index,

**Vanguard Information Technology Index**

29:34

and there are a few sort of pieces of information here that I think sort of give us a different

29:40

feel I think. Patrick Shepherd: Yeah this is tricky. So here we have an area of the economy, at least that we’re focusing on.

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Right. We’re looking at an index. We’re focusing on stocks of large, medium size, and small US companies.

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That’s all fine, but then it says in the Information/Technology sector.

30:02

The word sector is even there, so it sort of raises some, you know, is this a sector

30:07

fund? I don’t know. Cheryl Kane-Piasecki: Well I think if we look a little more closely at when it talks about

**Sectors**

30:13

the sector, it says, it’s made of companies in three general areas, technology software and services, information technology consulting and services, data processing and then it

30:26

looks like its Patrick Shepherd: Hardware and equipment. Cheryl Kane-Piasecki: Computer and hardware. I mean in my opinion that’s all still all intimately related.

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I don’t see those as being entirely different industries. I mean that’s in my opinion, if you are CIO, you’re doing all that stuff.

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I mean at affecting, that is the industry you’re primarily going to have engagement

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with. Okay, as a helpful resource, just to kind of give you guys a sensibility about where,

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because Patrick had talked about some language that he thought was illustrative of, in the first example, of being something that’s likely not a sector fund.

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We have a DAEOgram, what we used to call DAEOgrams, a legal advisory dating from 2000 that talks

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about diversified and sector mutual funds, and at the end of that advisory we do include

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a list of sector fund examples. So we give some titles that we think could be an indication of a sector fund, we’re

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not saying this is absolutely dispositive, but we’re saying that these are likely to be sector funds. We give a list of that, and we give a list of things that we think are more likely to

31:41

be diversified. Patrick Shepherd: And I think you know, there’s something to important to remember here is

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that just because something has a focus, doesn’t necessarily mean that it is a sector mutual

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fund. So we really need to look and see, are we focusing just in one business sector, the

31:59

bonds of one state, one country, because it’s possible to have, say a focus in more than one country.

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So you might be familiar with the Brick Fund, the Brazil, Russia, India, China Fund, that’s a diversified fund.

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It’s not invested in one company. Some of the healthcare funds, when you look at some of the healthcare funds you see that

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they invest in hospitals, in pharmaceuticals, insurance companies, consulting firms, all

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over the place medical devices, and all these are included, and each of those individually might be an industry, but in aggregate, it’s more than one industry, so it actually might

32:36

qualify as diversified. So just because something seems to have a focus in an area, doesn’t mean that area

32:43

is necessarily one industry, or one company, or one country outside of the US, you have to look a little further.

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This opinion lays that out really well. Cheryl Kane-Piasecki: And here’s just another example from the talks about different diversified

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funds examples, so as you were talking about you know, small cap, mid cap, large cap, venture

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capital, generic science, technology, consumer products, service, and etcetera. And we’re going to sort of see that here when we get into this iShares US Industrials.

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So I mean, I making the call that I think that other one was a sector fund. I think that the IT technology thing was a sector fund.

33:23

Patrick Shepherd: Because they seem to be focused on technology hardware. Cheryl Kane-Piasecki: Yes. Patrick Shepherd: Right. They weren’t kind of all over the place, it was like,

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Cheryl Kane-Piasecki: It wasn’t technology like technology across industries, it was information technology is what it was.

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Patrick Shepherd: People who make computers. Cheryl Kane-Piasecki: Yes, exactly. So, but if we look at the iShares US Industrials, this is one where what you were just talking

33:44

about Patrick, I think comes really into play. IT’s talking about the performance of the Industrial sector of the US equity market.

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Patrick Shepherd: Right. Cheryl Kane-Piasecki: So that’s construction and materials, aerospace and defense, general

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industrials, electronic and electrical equipment, industrial engineering, industrial transportation, and support services.

34:01

Patrick Shepherd: So this is all over the place. Cheryl Kane-Piasecki: It is all over the place. Patrick Shepherd: So we’re talking about industrial stuff, but that could be in the

34:11

mining area, in electronics, in industrial engineering, transportation. So we’re talking about trucks and IT systems.

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Cheryl Kane-Piasecki: Right. Patrick Shepherd: Right. So we’re all over the place. So even though this excludes some parts of the economy, it’s still probably diversified.

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Cheryl Kane-Piasecki: yeah, because it’s not one single industry. Patrick Shepherd: Right. Cheryl Kane-Piasecki: Okay, so in terms of whether or not the fund is diversified, for

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purposes of the diversified mutual fund exemption, we’re calling it that Wells Fargo is diversified,

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so it would qualify for the diversified fund exemption, and the iShares US Industrials, contrary to what I looks like when it’s phased,

34:48

Patrick Shepherd: Right. Cheryl Kane-Piasecki: is also subject to the diversified mutual fund exemptions. So we’re left with Vanguard. The Vanguard information Technology Index is not diversified.

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So then we have to look at, does the value of the interest meet the de minimis?

35:04

So for the sector mutual funds, well for the diversified mutual funds there is no de minimis. Patrick Shepherd: Can have as much as you want. Cheryl Kane-Piasecki: You could have millions of dollars worth.

35:11

Patrick Shepherd: Right. So then you buy your spider shares or Vanguard total market fund of whatever you have, as much as you like.

35:17

It’s diversified so we don’t have to worry about it. Cheryl Kane-Piasecki: But for our sector mutual funds, there is a de minimis threshold, and

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the de minimis threshold is fifty thousand dollars or less. Patrick Shepherd: Okay. Cheryl Kane-Piasecki: Okay.

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So when we look at how much our employee has, our employee has twelve thousand dollars, and twelve thousand dollars is clearly below the fifty thousand dollar threshold.

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So while they can’t avail themselves at the diversified mutual fund exemption, they clearly can avail themselves of the sector fund

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Patrick Shepherd: Excellent. Cheryl Kane-Piasecki: exemption. Patrick Shepherd: And on the last slide I saw you have aggregate. Sometimes we’ve got to add them up. So if he had a few of these technology funds or funds that might be affected by a matter,

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we take all those together. We have to do some math. Cheryl Kane-Piasecki: Yes, exactly. He only has one, but if he has more than one, we would have to aggregate those.

36:00

Patrick Shepherd: Okay, great. Cheryl Kane-Piasecki: And also if, I think, spouse or minor child, we would also have to aggregate those.

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Okay. So for purposes of our first example we basically said, that’s how you march through a mutual

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fund and unit investment trusts exemption analysis, and we found that we had two that were diversified, that were subject to that exemption, and we found one that was a sector

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fund and was subject to that exemption. Now just a really quick word, and I mean really quick word. There’s another exemption for sector mutual funds that seems a little bit more opaque.

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Patrick Shepherd: Yes. Cheryl Kane-Piasecki: Sometimes the best way to describe or to explain that particular

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exemption is through an example. So effectively what the other sector fund example is trying to get at is, let’s say

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our CIO has a sector fund, his conflicts are with the IT industry, right?

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So let’s say that he has a sector fund that doesn’t concentrate its investment in IT,

37:03

it concentrates its investments in the financial services or in banking. Patrick Shepherd: Okay, so he’s got the investment company banking fund 2019 or whatever,

37:12

so okay. Cheryl Kane-Piasecki: Right. So he’s got this banking fund. It’s a sector fund, so it doesn’t qualify for the diversified mutual fund exemption,

37:20

right? So, and some of the holdings in that. Even though it’s a banking sector mutual fund,

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Patrick Shepherd: Right. Cheryl Kane-Piasecki: Some of the holdings are actually IT companies with which he would have a conflict.

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Patrick Shepherd: So we might look at this fund up, and it says we might make sure that eighty-five plus percent of our investments are held in the banking sector.

37:41

We may temporarily hold equities in other kinds of companies.

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Cheryl Kane-Piasecki: Right. Patrick Shepherd: And on this particular day, let’s say they have some Amazon shares in

37:52

the banking fund, and they need somewhere to put the money, they were out of banking stock ideas, and they said let’s dump some in Amazon for the day.

37:59

This says we don’t have to go in there every day, and simply, do they hold Amazon? Cheryl Kane-Piasecki: This basically says that we don’t care if the person has a sector

38:08

fund that has conflicting holdings in it provided that the sector in which it’s invested isn’t

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the conflict. So if they have a sector mutual fund that’s min a sector that does not conflict with their duties, then we don’t care if that sector fund actually holds potentially conflicting

38:25

holding, as long as they’re not the emphasis, it’s not the sector in which the fund invests. Patrick Shepherd: And especially some of these funds that are more actively managed.

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Those holdings could change daily or even hourly, so it’d be administratively impossible to monitor this.

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So what this basically says is we don’t have to monitor it. eCheryl Kane-Piasecki: Right. Patrick Shepherd: We look at the sector that they say they’re focused on.

38:45

If that poses a conflict, we look to see if we can use the de minimis. We don’t have to look through and say, “oh at the bottom of page nine of the prospectus

38:53

it said for a minute last year they held some Microsoft stock, so therefore you violated

38:59

208.” This exemption takes care of that problem. Cheryl Kane-Piasecki: Yeah, this exemption means you don’t have to worry about this at all. So it’s helping you to not have to think about it really at all.

39:07

So the only time you really have to be worried is if someone has a sector fund, and it’s in a sector where they actually have a potential for conflict.

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Patrick Shepherd: Okay, great. Cheryl Kane-Piasecki: Okay. So that was our treatment of mutual funds and unit investment trusts exemptions.

39:20

So we’re going to move on to the publicly traded securities, and this is our second exercise. Our second exercise is, we now have a different employee, and this employee is going to be

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working on a regulation, and this regulation sets standards to reduce harmful bacteria

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at facilities that manufacture frozen dinners. Okay. We all need that, right?

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Okay. So employee spouse and twelve year old son inherited ConAgra stock, $2,500 each, and

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the employee also has $12,000 worth of stock in Nestle. So going back to our analysis process, the first thing we have to say is, do we think

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we have a potential conflict of interest between the employee’s duties, and these particular interests that we’ve identified?

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Patrick Shepherd: Yeah, I think so. It seems to be a standard setting for regulations of frozen food manufacturing could implicate

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the financial interests of ConAgra or Nestle, because you know, we know or could find out

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that they’re involved in those areas. Cheryl Kane-Piasecki: but just the regulations, I mean the fact that it’s a regulation,

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I mean this isn’t like we’re going to contract with them or we’re investigating them, so why do we care about a regulation?

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Patrick Shepherd: Well it seems that this regulation is focused on a particular kind

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of business. We’re not talking about a change to cooperate tax rates, we’re talking about a regulation

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of companies that manufacture frozen food, and I think those companies probably are a

40:46

discrete and identifiable class, so therefore we might have a particular matter of general

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applicability here, which is covered under section 208. Cheryl Kane-Piasecki: okay. So this is a particular matter that we’re dealing with, even though it’s not a specific

41:00

party matter, it still falls within that matter of general applicability definition that we have also in the regulation.

41:05

Okay, and if you do look up ConAgra Foods, you’ll see that they are manufacturers of healthy choice and banquet frozen meals just to give you a sensibility about why we care

41:14

about ConAgra, and then Nestle of course, they do Stover’s and Lean Cuisine, and some other frozen foods.

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Patrick Shepherd: Okay, so we’re clear that they’re going to be regulated. Cheryl Kane-Piasecki: Yeah. For sure.

41:25

Okay, so the potential for gain or loss to the employee is, you know, is clear they have

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these interests in these food companies. Patrick Shepherd: In these companies. Cheryl Kane-Piasecki: In these companies, and that was exactly what I was going to get

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at is, how do we analyze stock holdings, because a lot of folks would say, “well, you know, a regulation, yeah, yeah, you know, it’s probably going one way or the other, it’s

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going to affect the bottom line of the company, but is it really going to be so much as to affect the stock price.”

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Isn’t the stock price really what we’re worried about here Patrick? Patrick Shepherd: No. Cheryl Kane-Piasecki: No, what do you mean no?

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Patrick Shepherd: Yeah, I think this is an area, I think it’s a good idea to focus

42:05

on this, maybe a little bit in training, you know, when you have people who might have financial conflicts.

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When you own shares in a company, you own shares in a company. You get the right to vote on company decisions.

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You literally own part of the company. So we treat the companies interests like the employee’s interests.

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I’m going to say if something affects the company and you’re an owner of that company, then it affects you.

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So we don’t have to ask if this regulation is going to affect the share price of Nestle of ConAgra. Cheryl Kane-Piasecki: Right, right.

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Patrick Shepherd: We just have to know that they’re going to have to spend money or do something differently to come into compliance with it, you know, their regulatory environment

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is going to change, it’s going to affect them financially. So therefore we have a nexus and a potential for gain or loss. Cheryl Kane-Piasecki: Okay.

42:50

Very good. So which exemption might apply well again, you know we have exemptions in 202 for interests

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in securities. So we need to figure out whether or not that exemption or that series of exemptions could

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apply to our holdings, our employee’s holdings. So just as with mutual fund, again, get really cozy with the definition section, because

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you’re going to need to know what a security is, and what a publicly traded security is,

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because if we look at the definitions for the security exemptions in 202, the requirement

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is that it be a publicly traded security. So a security, it could be a common stock, preferred stock, a corporate bond, municipal

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security, long term Federal Government Security, etcetera, etcetera, but the key here is that

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in order to use the securities exemptions, they have to be publicly traded securities, and we have a definition for that.

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So Patrick, what do we mean by that? Patrick Shepherd: Two definitions for one sentence. Cheryl Kane-Piasecki: For one sentence, yes.

43:48

Patrick Shepherd: So publicly traded means that the security, it has to be a security first, is registered with the SEC and listed on a national or regional exchange, or traded

44:00

to the NASDAQ. Cheryl Kane-Piasecki: Okay. Patrick Shepherd: So we have, it’s a two parter. We have to be registered with the SEC under the Act of 1934, and we have to be listed

44:10

on exchange. Cheryl Kane-Piasecki: Yes, okay.

44:16

So we understand that that’s the definition of publicly traded security for purposes of

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the exemption. So what do you think these things have in common Patrick? Patrick Shepherd: This is a tough one.

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Cheryl Kane-Piasecki: Because they all look very familiar don’t they? Patrick Shepherd: Yeah, these are companies that we’re familiar with, and these are

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places that we’ve probably shopped, have products in our homes made by some of these. Cheryl Kane-Piasecki: They’re not small. Patrick Shepherd: They’re not small organizations, but I suspect they all sort of gave it away

44:43

here. I don’t think these are publicly traded securities. Cheryl Kane-Piasecki: And you would be absolutely right.

**Private Companies**

44:49

Patrick Shepherd: I remember Dell used to be and then they went private again. Cheryl Kane-Piasecki: Okay, so what do we mean by that? What does that effectively mean when we say, oh that’s not publicly traded?

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Patrick Shepherd: We can’t go out to the New York Stock Exchange, or any of the other exchanges and buy shares on the common market.

45:04

Right? Basically these are private companies. There may be ways to have equity in them, they can issue shares as private companies,

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but they’re not traded on exchange. You can’t go to the New York Stock Exchange, look up the ticker symbol, and buy a few shares.

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That’s not how they’re traded. Cheryl Kane-Piasecki: And how would you know that? Like how would people know that? How do you find out?

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Patrick Shepherd: Well the easiest way that I’ve found is to try and do just that, to try and find these companies either in a financial research website, or on a market, and see

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if you can a ticker symbol, because if you go out and find Dell’s ticker symbol right now, you’re not going to be successful because they don’t have one, because they’re not

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registered with the SEC, and they don’t trade on exchange. Cheryl Kane-Piasecki: One thing I also found really helpful, actually when I was preparing

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to do this presentation was, I actually went out and did a search for the largest private,

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Patrick Shepherd: Privately held companies. Cheryl Kane-Piasecki: Privately held companies, and every year, and I don’t mean, this is no endorsement here, but every year Forbes does a list, like a top twenty or whatever

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list. So if you just want to kind of get yourself a little familiar of the universe with like

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the biggest players, the ones you might most likely see if you’re going to see these, you can always do that. Go out and take a look and see if you can find a resource that can give you a list,

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a current list of the large privately owned companies Patrick Shepherd: What’s kind of nice about privately held companies, is that they’re

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hard to get equity in. So you’re not likely to see these with most employees.

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So it’s a thing to check on, but you’ll find that because they aren’t traded on exchange, they’re difficult to buy shares of, they’re difficult to get equity interests

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in, so they don’t come up that often, and it’s important to know that that’s a requirement.

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Cheryl Kane-Piasecki: Okay. So for our first listed security we have ConAgra foods, and so we’ve sort of highlighted

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a few things here, Patrick, and what is the significance the little stuff that we’ve circled?

46:57

Patrick Shepherd: So we have to nice things here; one we have a ticker symbol. We have a three letter ticker symbol, and it indicates that it’s traded on the New

47:04

York Stock Exchange. NYSE stands for New York Stock Exchange. So we understand here that this is probably going to be publicly traded.

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If you’re traded on the New York Stock Exchange, you’re almost assuredly going to meet the definition. Cheryl Kane-Piasecki: Okay, so we’re going to go with that.

47:19

Patrick Shepherd: Publicly traded. Cheryl Kane-Piasecki: ConAgra’s a publicly traded thing. Okay, so now let’s look at Nestle.

47:24

Patrick Shepherd: Oh no. Cheryl Kane-Piasecki: Oh no, that’s a good sign Patrick, what do we mean by oh no?

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Patrick Shepherd: That’s less good. Cheryl Kane-Piasecki: Okay, what are we looking at and why did you say “oh no?” Patrick Shepherd: So we have some strange things happening here, and we have actually,

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both indicators of some strange things here. We have a five letter ticker symbol that does not end in x.

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It looks like the ticker symbol is NSRGY, and then we have a suffix.

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It says .PK, and I know that .PK stands for pink sheets. Cheryl Kane-Piasecki: Pink sheets.

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Patrick Shepherd: And if you’re not familiar with pink sheets, the pink sheets are sort of an anachronism, because nothing’s traded literally over the counter, but these were

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literally traded on pink slips of paper, not on an exchange, and when we see here, we see

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that the market indicated other OTC. OTC means over the counter, so that’s not an exchange, that’s a privately, in other

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words it’s not traded on exchange. So it’s not going to meet the definition of publicly traded for our purposes.

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Cheryl Kane-Piasecki: Oh boy. Patrick Shepherd: And I think the reason for that is Nestle is not an American company, so they’re probably not going to the trouble of registering with the SEC.

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Cheryl Kane-Piasecki: Right. Patrick Shepherd: So they might be traded on a foreign exchange, they almost assuredly are, but if an American investor wants to purchase Nestle, they have to do it through

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the pink sheets or over the counter. Cheryl Kane-Piasecki: Gotcha. Patrick Shepherd: So we have a problem here because our definition of publicly traded

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says it has to be traded on a US exchange. Cheryl Kane-Piasecki: Okay, okay. So it looks like that if this is what they have are these regular shares, these Nestle

48:59

regular shares, that looks like they’re traded over the counter, they’re not traded on an exchange, so these are not going to be eligible for the publicly traded securities

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exemption. Patrick Shepherd: They are not. Cheryl Kane-Piasecki: Okay, well one thing I also found is that Nestle also has what

**ADRs**

49:15

are called ADRs, so you can buy Nestle either Nestle stocks or you can buy a Nestle ADR.

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You want to give us a quick and dirty about what an ADR is? Patrick Shepherd: Yeah, so Nestle, as a foreign company, would like to be able to raise money

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from American investors. So they could do that by trading their common shares over the counter through the pink sheets,

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and though a whole bunch of investors that won’t be able to avail themselves of that. You know, the trading fees might be a little higher, certain types of retirement accounts

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might not allow you to hold them, your broker might not be able to get them for you. So Nestle says, you know, “we like being traded on the London Exchange”, or wherever

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they’re being traded, “but we would also like to raise capital from US investor,”

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so we’re going to make a thing called the American Depository Receipt, which is kind of like a fake share, and these sometimes trade on exchanges, sometimes they don’t,

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but they can set up an American Depository Receipt program, where those receipts trade

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on exchange just like a stock, they’re registered with the SEC just like a stock, they are securities,

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and basically it’s a piece of paper that entitles the holder to all of the benefits

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that a shareholder would have, without actually having the shares. So there’s sort of sort of an administrative work around for wanting to raise capital on

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more than exchange in more than one country. So they prefer to be traded in their home country, but they’d also like to sell securities

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in the US, so they set up an American Depository Receipt program, and maybe they go and get it listed on New York Stock Exchange, and it gets a ticker symbol, and then good to

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go. We can use our publicly traded situation, our exemption.

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Those ADRs also might trade over the counter, so we still have to look. It doesn’t automatically mean we don’t have a problem, it just provides the possibility

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that it’s traded on exchange. Cheryl Kane-Piasecki: Yes and so if you look at the next slide that we have, and we’ve given two different examples of ADRs, and the first ADR is the one that you referred,

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Patrick, where it’s actually traded on an American exchange, it’s traded on the New York Stock Exchange.

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That ADR qualifies for the securities exemption because it’s registered with the securities exchange commission, it has a ticker symbol, and it’s traded on an American exchange.

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Patrick Shepherd: Yep. So yeah, so we have BTI that looks like a normal ticker symbol that would be traded on the New York Stock Exchange and we have an indication that that’s true.

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Cheryl Kane-Piasecki: BTI is not what our person has. Patrick Shepherd: It is not. Cheryl Kane-Piasecki: What our person has is Nestle, and when I looked up the Nestle

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ADRs, this is what I got on the Nestle ADR. They’re not, they’re trade over the counter, they’re not traded on an American exchange.

51:58

So the Nestle ones would not be eligible for the securities.

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So this is where we stand with respect to this publicly traded securities exemptions, in terms of whether or not they’re even available.

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For ConAgra, yes, for Nestle, whether they hold Nestle stock or a Nestle ADR, neither

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of those qualifies for the securities exemption.

**Specific Matter**

52:20

So the next thing we have to figure out is, what is the kind of matter that the employee’s

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going to work on? So for this one, for ConAgra, we know that ConAgra is eligible because it’s a publicly traded security, so we need to know what type of particular matter the employee’s going

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to work on because we have several different securities exemptions that you can use, and it’s all going to depend on what the nature of the matter is that the employee is working

52:44

on. Now we said at the beginning that employee’s working on what? Patrick Shepherd: A rule making. Cheryl Kane-Piasecki: A rule making, a regulation, a standard setting regulation.

52:53

So that would fall into the category of? Patrick Shepherd: Particular matters of general applicability.

52:59

You don’t generally have parties to a rule making except in very rare instances. So it’s not a particular matter involving specific parties, it’s going to affect the

53:09

discrete and identifiable class of frozen food manufacturers, so it is therefore a particular matter of general applicability.

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Cheryl Kane-Piasecki: So when we look at the exemptions, we realize that this matters because

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the dollar value de minimis that they can hold and still be outside the restrictions

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of the conflict of interest statute are going to depend on the nature of the matter that they’re working on.

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Our person’s going to be working on a matter of general applicability. So dollar values that they can hold in all affected entities, while they’re participating

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in this matter of general applicability, or they can hold no more than 25,000 in any one,

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but if they have more than one and they have to aggregate, they can’t have more than 50,000 in all affected entities.

53:53

Patrick Shepherd: Okay. Cheryl Kane-Piasecki: Okay. So in terms of the matter of general applicability exclusion for publicly traded securities,

54:03

we know that Nestle stock doesn’t qualify, so we can’t even think of that one. Patrick Shepherd: They failed the threshold question.

54:09

Cheryl Kane-Piasecki: They failed the definitional question. The ConAgra stock, we meet the de minimis threshold because we only have 5,000 and that’s

54:17

the 2,500 from the spouse, and the 2,500 from the minor child we’ve aggregated, and 5,000

54:23

in that stock is less than the 25 in a single affected entity.

54:29

Okay, so that was our analysis for publicly traded securities.

**Stock Options**

54:35

So Patrick how do we handle stock options? Why ae stock options different and are they eligible for our exemptions?

54:42

Patrick Shepherd: That’s an excellent question. So stock options are a little bit tricky, and if you’re not familiar with what an

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option does, it either creates the right to buy or sell shares at a particular price,

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at a fixed rate certain in the future, or creates the obligation to do the same. So these are contract between individuals that allow them to get the benefits of, a

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magnified benefit actually, of holding the equity share, and they represent very similar

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concerns to ownership of the actual company. Actually in some ways it’s a magnified concern, so you know, if you have options on a particular

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company, that share price moves up and down. The amount, the value of your option changes based on the amount that the shares’ price

55:38

changes is magnified. You know, sort of the sense there they magnify your interest in the value of the company.

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So they create all the same concerns we have with stocks. Right.

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You know, the things that affect the companies are going to affect you. So for conflicts of interest purposes, we treat them the same.

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The problem we have here is that they aren’t securities. There’s not an exchange.

56:04

Cheryl Kane-Piasecki: You don’t actually hold a security in the company. Patrick Shepherd: Right, you don’t have, Cheryl Kane-Piasecki: It’s a promise to, Patrick Shepherd: It’s a contract.

56:10

Cheryl Kane-Piasecki: Yeah, it gives you permission to at some future date, Patrick Shepherd: Right, you have either a right or an obligation, and there’s a counter

56:18

party to it. So there’s not a ticker symbol for stock options. You can’t go on New York Stock Exchange and look up the options symbol and buy an

56:27

option. You have to go through a broker’s house and write an option and find someone who will take the other side of it with you.

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So they’re not publicly traded securities, but they give you an equity interest, just like stock does.

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So we treat them the same for 208 generally, but then when we look to see if the de minimis

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exemption is available, we find that it isn’t because they are not publicly traded for our

56:52

purposes. Cheryl Kane-Piasecki: So typically then, what do we ask people to do if we know that they have an insuperable conflict with options, they’re not going to have the de minimis

57:02

exemption available to them. Patrick Shepherd: Yeah, so we have to look for another remedy. So you know in most cases, if it’s possible to divest of the option that poses a potential

57:12

conflict, that’s the cleanest way to go. Otherwise you have to look at recusal, or I think in rare instances maybe a waiver would

57:19

be appropriate. Cheryl Kane-Piasecki: Can you just forfeit them? Patrick Shepherd: Sometimes. Sometimes you can just say, it depends.

57:26

You know, some sorts of incentive stock option that you might have from a previous employer,

57:31

that invested could be forfeited. Options that you just bought on the market may be a little different.

57:37

Cheryl Kane-Piasecki: Okay. So that was our treatment of stock options. Now I know that when we looked at the definition of security, security included, it said you

**Corporate Bonds**

57:46

know, preferred stock and common stock, and it also said, you know, corporate bonds, and I don’t know how often people run across corporate bonds as a publicly traded security,

57:56

but what I did want us to spend just s minute here just to talk about why do we care about corporate bonds, and how is the 208 analysis for corporate bonds different from the analysis

58:07

for stock holdings, and I think one of the critical differences is that you know, with

58:14

stock holding, it’s an ownership interest in the company, and clearly anything that affects the company affect you as an owner of the company.

58:22

When you have a corporate bond, you don’t own the company, you’re helping to purchase its debt, correct?

58:28

Patrick Shepherd: Yeah, the company owes you money. Cheryl Kane-Piasecki: Right. Patrick Shepherd: Right. Cheryl Kane-Piasecki: So once we’re dealing with a debt obligation, it’s like any other

58:34

debt obligation where our primary concern is going to be anything that would so affect

58:39

the company as it would affect its ability to make good on its debt obligations. Patrick Shepherd: Right. No, exactly.

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So you know, we’re looking at whether or not you could affect the ability or willingness of the company to make good on that obligation.

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When you bought the bond, you bought a promise to be paid with interest, and we want to make

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sure that you don’t do anything to affect their ability to make good on the promise. Cheryl Kane-Piasecki: Right.

59:03

When the only other way that you could affect it is if somehow you could affect the bond rating, like if you were engaged in some sort of matter that would actually affect the bond

59:10

rating. Patrick Shepherd: Right. We could change the value of the bonds that way. So it’s a lesser standard.

59:16

Cheryl Kane-Piasecki: Okay. Patrick Shepherd: Right. Cheryl Kane-Piasecki: So it’s not as direct. Patrick Shepherd: It’s not as direct, yes. Cheryl Kane-Piasecki: You’re financial interest is not as direct.

59:23

Patrick Shepherd: Right. Cheryl Kane-Piasecki: Okay. So we’re going to turn to our final exemption that we promised we would cover today, which

59:33

is employee benefit plans, and OGE just very recently issued an advisory on employee benefit

59:42

plans. I think we issued that in 2015, I believe, let me get it here, let me just pull it up

59:49

quickly. Yeah May 5th of 2015, where we explained a little bit further how to interpret the diversified

59:57

pool investment fund exemption, and we’re going to be looking at a couple of examples

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here to help sort of sort that out, but just to let everybody know, and I think we gave

1:00:08

you a copy of this. We sent you a copy of this, which is LA-1506.

1:00:13

So our first example for this is, you have someone new, he’s investigating discrimination

1:00:19

complaints in HUD’s Office of Fair Housing in the Philadelphia Regional Office. This person previously worked for the city of Philadelphia and has retained and interest

1:00:29

in its 457 Deferred Compensation Plan. One of the investments in the plan is the T Rowe Price Real Estate Fund, and it invests

1:00:38

80% of its assets in the equity securities of real estate companies.

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So what are we concerned about here? What would we potentially be concerned about here, Patrick?

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Patrick Shepherd: Well we do investigations it looks like, and as we know from the definitions

1:00:55

an investigation qualifies as a specific party matter, and specific party matters are particular

1:01:02

matters for purposes of 208. Cheryl Kane-Piasecki: Right. Patrick Shepherd: So we’d be concerned about a nexus between these discrimination investigations,

1:01:10

and maybe the holdings of the 457. Cheryl Kane-Piasecki: Yeah, and what does it look, the one here, I mean we focus just

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on the one here, the T Rowe Price Real Estate. Patrick Shepherd: Yeah. Cheryl Kane-Piasecki: Real Estate Fund.

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I mean HUD deals in real estate obviously and so if you’re investigating, you’re investigating real estate.

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So that’s the cause for concern, why we would even look at this and wonder if we needed

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to avail ourselves of an exemption. So because this is a holding inside of a pension plan, we want to look at the employee benefit

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plans exemption first, I think, because it is held within the confines of a plan.

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Patrick Shepherd: Right. Cheryl Kane-Piasecki: So what .201(c)(1)(ii) says is, you can participate in any matter

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where the disqualifying financial interest arises from the underlying holdings of a pension

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plan that’s established by a state government or a subdivision of the state for state and

1:02:08

local employees. So let’s go back to our example and look at that. Okay.

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So we’re looking at, you can participate in any matter, so if the exemption applies

1:02:19

that would include an investigation, where the disqualifying financial interests in is

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one of the underlying holding of a state pension plan that’s sponsored by a state government

1:02:32

for its employees. Patrick Shepherd: So this is a city pension. Do we think a city is a political subdivision of a state?

1:02:41

I guess it is. Cheryl Kane-Piasecki: Yeah, so we’re looking at a state government or a subdivision of

1:02:46

the state. Patrick Shepherd: Okay. Cheryl Kane-Piasecki: And I would say I think the city of Philadelphia is a subdivision of the state of Pennsylvania. Patrick Shepherd: Great.

1:02:52

So this seems easy. Cheryl Kane-Piasecki: Although Pennsylvania isn’t a state. Patrick Shepherd: Do we have a definition of a state?

1:03:01

Cheryl Kane-Piasecki: I’m not sure that we do. So yes. So I think our employee benefit plan exemption would apply here because we don’t have to,

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it’s just simply the fact that it is a plan, and the entire plan is what is being exempted

1:03:17

here, right? Patrick Shepherd: Right. Cheryl Kane-Piasecki: So we’re saying that because the conflict arises, because of one of the underlying holdings, but that underlying holding is contained within a plan that is

1:03:28

sponsored by a state or local government. Boom the entire plan is Patrick Shepherd: End of analysis. Cheryl Kane-Piasecki: End of analysis.

1:03:33

Why do you think we devise such what appears to be a broad exemption for state and local

1:03:39

government? Patrick Shepherd: I suspect because the provisions and the tax rules that establish the authorities

1:03:46

for states to create these put some restrictions on the kinds of things that they can offer through them, and that we found that these offerings are fairly innocuous from a conflicts

1:03:55

of interest perspective. Cheryl Kane-Piasecki: Yeah, I think that the types of things that they can invest in in

1:04:03

state pension plans are probably fairly conservative. Okay so let’s move on to our next exercise which is, we have an attorney at the Consumer

1:04:15

Products Safety Commission. Patrick Shepherd: Okay. Cheryl Kane-Piasecki: Prior to joining the Consumer Product Safety Commission, they were

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in-house counsel at Sharpe Toys. Patrick Shepherd: Great. Cheryl Kane-Piasecki: Yes, bag of glass.

1:04:27

That’s from a Saturday Night Live skit. Sharpe Toys has a 401(k) that’s administered by Integrity, Inc., and through that 401(k),

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your employee has selected some individual stock holdings. So this is a 401(k) where they actually just give you things other than mutual funds that

1:04:42

you can invest in. So you’re invested in 14,000 at XYZ Corporation, and now at CPSC you’ve been asked to participate

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in litigation against. So what’s our concern here? Patrick Shepherd: So we’re litigating against, we’re involved in litigation against XYZ

1:04:58

Corp. So that’s going to be a specific party for us, I think. Through our 401(k), our tax advantaged account established by Sharpe Toys, we hold common

1:05:09

shares of XYZ Corp.

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That seems like a problem. Cheryl Kane-Piasecki: We’re back to our securities issue. You’re still an owner of XYZ Corp., and I don’t think under any wild imagination

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you could say it would be okay to be an attorney litigating a company of which you were an

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owner. That’s kind of conflict of interest defined. Patrick Shepherd: Yeah, that seems like a pretty clear nexus.

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Cheryl Kane-Piasecki: Yes, I think so too. So if we look at the employee benefit plan exemption in 201(c)(1)(iii), here I’m actually

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quoting from the LA, the legal advisory that we’ve given you because the legal advisory

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is the thing you’re going to have to look to help you understand the way 201(c)(1)(iii) is worded, because the wording in 201(c)(1)(iii) is a little opaque.

1:06:09

So I’m quoting from the legal advisory, and the legal advisory says, where a particular pulled investment fund meets the definition of diversified in part 2640, an employee may

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rely on the exemption as to that fund when the employee holds the fund through a qualifying

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employee benefit plan. So we’ve got to start by making sure the employee benefit plan qualifies, that it’s

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sort of independently managed, and once you’ve determined that, then the exemption is going

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to reach to the plan, and any holdings in that plan that meet the diversified definition.

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Patrick Shepherd: Right. Cheryl Kane-Piasecki: Where you can’t avail yourself of this exemption to reach into an

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employee benefit plan to exempt certain holdings, is if those holdings are non-diversified,

1:07:03

either pulled investment funds or other individual assets like stocks or bonds, or anything else

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like that. Patrick Shepherd: So I think this makes sense. You know, if you have a situation where you have the plan, and it meets those independently

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managed criteria, but through that plan you own common shares of a specific company, the

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fact that the plan meets the criteria doesn’t really matter to us, what we’re concerned with is that in this case you own XYZ Corp.

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Cheryl Kane-Piasecki: Right. Patrick Shepherd: Right, whether you own in this account, or that account, or some other account over there, you own it.

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So we treat it like you own it. Cheryl Kane-Piasecki: Yes, and you can’t use this exemption. Patrick Shepherd: You can’t use this exemption to fix the problem.

1:07:46

Cheryl Kane-Piasecki: Right. Patrick Shepherd: However, if you have something in this plan that’s diversified for purpose

1:07:53

of our definition of diversification, sure, that’s what we’ve intended this for. Cheryl Kane-Piasecki: Right, and I think that what I want to sort of clarify for folks is

1:08:01

kind of like, I’m sure there’s people saying, well why do we need this? If we have the diversified fund exemption, then why do we need this employee benefit

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plan exemption? And I think what this is really trying to reach to is, you have employers who create

1:08:15

very nichey sort of, even diversified funds that are offered exclusively through their

1:08:24

employee 401(k). Patrick Shepherd: Right. Cheryl Kane-Piasecki: That you couldn’t get publicly, they’re not traded on any

1:08:30

public exchange, they’re crafted precisely for, Patrick Shepherd: So they’ve not jumped through the SEC hoops,

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Cheryl Kane-Piasecki: Right. Patrick Shepherd: For these pooled investments, because they’re only offering them to employees

1:08:42

of the company. Cheryl Kane-Piasecki: Right. Patrick Shepherd: But for our purposes they look a lot like diversified funds.

1:08:48

Cheryl Kane-Piasecki: Right. Patrick Shepherd: So the fact that they don’t, they’re maybe not registered under the act, or they don’t have the proper ticker symbol, we say, well you know, if it’s in the employee

1:08:58

plan, it meets those criteria, the independently managed criteria, and it’s diversified.

1:09:05

That’s kind of the same thing. So this exemption is meant to take care of that eventuality. Cheryl Kane-Piasecki: Right so it’s basically going to try get at, you know, anything that’s

1:09:14

in an employee benefit plan that otherwise would appear to sort of like qualify for the

1:09:24

diversified mutual fund exemption except that it’s not under the Investment Company Act of 1940. Patrick Shepherd: Right.

1:09:30

Cheryl Kane-Piasecki: So what we’re trying to say is, since you can use the diversified mutual fund exemption because they’re not under the Investment Act of 1940,

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Patrick Shepherd: You can use (c)(1)(iii). Cheryl Kane-Piasecki: You can use the employee benefit fund exemption, provided that the plan itself qualifies under our definition.

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So it’s really, it’s just a way to try to not wind up making disqualifying diversified

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types of funds that but for the securities act registration would not pose any more of

1:10:00

a problem than if they were under the securities act. Patrick Shepherd: Basically we have a different threshold consideration here. Cheryl Kane-Piasecki: Right.

1:10:05

Patrick Shepherd: For the mutual funds, first they have to be mutual funds, and then if they’re diversified the exemptions available.

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Here they have to be held in a qualifying employee benefit plan, and then if they’re

1:10:17

diversified, the exemption’s available. Cheryl Kane-Piasecki: Right, exactly. But we did not want to create some sort of huge loophole to allow people to otherwise

1:10:26

hold non-diversified, or like direct investments type, like securities types of investments,

1:10:34

and then just use the 401(k) as sort the subterfuge for allowing them to otherwise hold,

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Patrick Shepherd: Right, because all of the problems in here, in that situation, as to if you just hold in a non-tax advantage account.

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We’re trying to be sensible here. Cheryl Kane-Piasecki: Right, and that’s not to say that you couldn’t still use the securities exemptions for those securities if they’re publicly traded securities, you

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could still use those exemptions, it’s just saying you can’t avail yourself of this exemption to exempt things that let’s say, wouldn’t qualify for the other, you know,

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security exemptions. Patrick Shepherd: Exactly. Cheryl Kane-Piasecki: So yes, so we don’t think that the employee benefit plan exemption

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is going to apply to these individual stock holdings. It may cover other things in the 401(k) plan, but it is not going to cover these individual

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stock holding in XYZ Corp. Patrick Shepherd: Okay. Cheryl Kane-Piasecki: Okay, and that’s the last of our examples.

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I’ve given you a very, it’s a short list, it may not be entirely comprehensive, but

1:11:36

we think that the most significant resources that you’re going to need to deal 2640 exemptions, obviously the regulation itself, the diagrams that we mentioned earlier in the broadcast,

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as well as one that deals specifically with particular matters involving specific parties, particular matters in matters, the employee benefit plan LA, and then we have some guides

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that are on our website that we would encourage you to also look at that also give you some

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information about the application of these exemptions. Patrick Shepherd: I think in these cases this stuff seems very complicated, and I think

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where you really have a potential conflict under section 208, and you need to determine

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if an exemption applies, it is appropriate that you should be very careful in that analysis.

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Right, you want to go through an elemental analysis to make sure that if you’re going to use an exemption that it’s appropriate, you should rely on those definitions, but

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also, you needn’t become overwhelmed because you only need to do this where you have a real possibility of a 208 problem, so if you remember that the complexity can be frustrating

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at times, but if you think about what we’re doing, we’re basically allowing people to

1:12:49

participate in matters that otherwise be criminal. It’s appropriate that we’re very careful and specific in our analysis.

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Cheryl Kane-Piasecki: Yeah, and keeping with that, I would just say, be very friendly and familiar with part 2640 in terms of the definitions because the definitions absolutely matter,

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I mean they absolutely matter, so we would just encourage you as we did today to make sure that you’re always making reference to the definitions and assuring yourself that

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what you’re looking at is actually what you think you’re looking at, and you might have to do a little spelunking and in Edgar or online and be looking at some fun perspectives,

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but you really do need to drill down and make sure that what you’re looking at is what

1:13:30

you think you’re looking at. Patrick Shepherd: And these aren’t all the exemptions, 2640 has a number of other exemptions

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and in a future broadcast maybe we’ll revisit some of the less common, more common exemptions.

1:13:43

Cheryl Kane-Piasecki: And we really have given you the 64,000 foot treatment of these exemptions, but this was for people who don’t have a lot of familiarity with the 2640 exemptions,

1:13:53

it gives you a taste of the complexity without completely overwhelming you with the super abundance of detail.

1:13:59

Patrick Shepherd: and one administrative announcement for folks who may be 278 reviewers or folks

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who are looking to recruit new 278 reviewers for the annual filing cycle that begins in

1:14:12

May, we will be holding some distant learning events to help people prepare for the 278

1:14:19

review cycle. So if you’re interested in that, we do have a number of resources on the YouTube channel,

1:14:24

which is YouTube.com/OGEInstitute, and we will be adding to that collection in the coming

1:14:29

months. Cheryl Kane-Piasecki: Absolutely, so do we want to open up the phone lines for questions? Patrick Shepherd: Sure.

1:14:35

Female Speaker: Thank you. At this time if you would like to ask a question, please press star then one, you will be prompted

1:14:46

to record your first and last name. To withdraw your request, please press star two. Once again to ask a question please press star then one now.

1:14:54

Patrick Shepherd: While we’re waiting for our questions to sort of sum up, you know,

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remembering the relationship of the regulation to the law is very, very helpful here.

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So when you’re looking at 2640, you can avoid all sorts of confusion by remembering that it implements 18 U.S.C.

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Section 208. Cheryl Kane-Piasecki: Yes. Patrick Shepherd: And that’s pretty much all it does. If you can keep that straight, there’s a good chance that you’ll avoid frustration.

1:15:26

Cheryl Kane-Piasecki: Absolutely. Patrick Shepherd: And it doesn’t look like we have any questions on the hangout. Do we have any questions on the phone?

1:15:31

Female Speaker: At this time I’m showing no questions. Patrick Shepherd: Good, excellent. Well we either did a very good job or we’ve confused people so much that,

1:15:39

Cheryl Kane-Piasecki: they checked out a while ago. Patrick Shepherd: We’d like to thank everyone for joining us, and we look forward to seeing

1:15:45

you again for our future broadcasts, and thanks for joining us Cheryl. Cheryl Kane-Piasecki: Thanks very much.

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