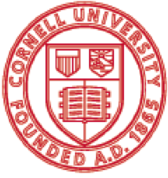

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March 31, 2023

VIA SEC COMMENT PORTAL

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Release No. 34-96768; File No. S7-02-23 (Proposed Revisions to Supplemental Standards of Ethical Conduct for Members and Employees of the Securities and Exchange Commission)

Dear Mrs. Countryman,

The Cornell Securities Law Clinic (the "Clinic") welcomes the opportunity to comment on the Supplemental Standards of Ethical Conduct for Members and Employees of the Securities and Exchange Commission (the "SEC"). The Clinic is a Cornell Law School curricular offering in which law students provide representation to public investors and public education as to investment in the largely rural "Southern Tier" region of upstate New York. For more information, please visit http://securities.lawschool.cornell.edu.

The Clinic generally supports the SEC's intention to revise the supplemental standards of ethical conduct for its members and employees. Insider trading and other concerns are extremely important regarding SEC employee ethical conduct. Furthermore, these revisions also allow for a lessened burden on compliance staff, and for increased oversight and efficiency regarding securities transactions made by SEC employees.

The Clinic submits the following comments in support of four of the proposed amendments on which the SEC requested comments. The first proposal concerns the prohibition of SEC's employee ownership of financial industry sector funds. The second proposal relates to the elimination of pre-clearance, pre-reporting, and holding period requirements for Permissible Diversified Investment Funds. The third proposal concerns the automatic reporting of transactions of securities. Finally, the fourth proposal concerns the prohibition for members or

employees of the SEC to purchase securities directly listed to an exchange for seven calendar days after the direct listing effective date.

A. Prohibiting Employee Ownership of Financial Industry Sector Funds Will Prevent Conflicts of Interest.

The first proposal is to prohibit employee ownership of Financial Industry Sector Funds that have a stated policy of concentrating investments in entities directly regulated by the SEC. Amended § 4401.102(c)(1) significantly expands the scope of entities directly regulated by the SEC.

The Clinic supports the proposal because it would reduce the risk of conflicts of interest. The proposal is consistent with the SEC's risk-based approach, which efficiently prevents insider trading while allowing individual employees to invest in low-risk investments. While the Clinic understands that the divestiture period provision under 5 CFR 2635.403(d) is a standard provision of other governmental agencies' standards of ethical conduct, lack of guidance regarding the SEC's reading of unusual hardship and reasonable period concerns the Clinic. The Clinic suggests that clear guidance should be provided on what constitutes a reasonable period based on the specific nature of the SEC employee's particular duties and the nature and marketability of the interest.

B. Eliminating Pre-clearance, Reporting, and Holding Period Requirements for Permissible Diversified Investment Funds Will Reduce the Unnecessary Burden on the SEC.

The second proposal eliminates pre-clearance, reporting, and holding period requirements for Permissible Diversified Investment Funds, including diversified registered investment companies, money market funds, 529 plans, and diversified pooled investment funds held in employee benefit plans or pension plans.

The Clinic supports the change because the proposal promotes the efficient allocation of resources consistent with the SEC's risk-based approach. Because these funds pose minimal conflict of interest risks, the elimination of requirements enhances the employees' investor rights by reducing delays in investment choices, as well as relieves the unnecessary burden of the SEC's members and employees.

This proposal is also appropriate considering the first proposal. When the SEC directs employees to divest their investment in Financial Industry Sector Funds, employees are likely to consider investing in relatively low-risk investments, which include Permissible Diversified Investment Funds. If investments in Permissible Diversified Investment Funds increase accordingly, the elimination of these requirements will reduce the monitoring cost of the SEC as well as a burden on the SEC members and employees.

The Clinic further suggests the SEC provide clear guidance on what funds qualify as Permissible Diversified Investment Funds. Comments submitted by various persons reflect that current guidelines can lead to confusion.[1]

The Clinic disagrees with one unnamed SEC Staff Member's comments.[2] The commenter argue that 90 days is an unreasonable short time frame which will likely cause significant tax consequences and alter the diversity of the employee's holdings. However, it should be noted that tax consequences are a normal part of investing, and that 90-day timeframe provides staff with sufficient time to plan and execute their divestment strategy. Further, the commenter wrongly denounces the punitive object of the proposal. The proposed prohibition is not aimed at punishing or targeting individual SEC's employees' members, but rather to ensure that the SEC's regulatory function is not compromised. Finally, the argument that the proposal sets a horrible precedent and raises concerns about retroactive banning of holdings is unfounded. This argument overlooks the fact that the SEC has always had strict rules governing its staff conduct and potential conflicts of interest. As expressed above, the proposed rule is simply a continuation of this long-standing policy.

C. The Automatic Reporting of Transactions of Securities Gives Rise to Potential Invasion of Privacy Concerns and Uneven Liability on Members/Employees Who Have Not Received Consent.

Currently, members and employees are required to report the transaction of securities to the OGE (Office of Government Ethics) within 5 business days. The reporting of these transactions is manual and requires employees to confirm and provide evidence of transactions through the submission of brokerage or financial institution documents.

Section C of the Rule Proposal suggests the automatic reporting of purchases, sales, acquisitions, and dispositions. Under this model, financial institutions would report covered securities transactions and holdings data through third-party automated software. During the automated reporting process, the broker is acting as an agent of the member/employee and therefore the employee is responsible for complying with the reporting requirement. Additionally, if employees are unable to obtain consent from the brokerage or financial institution to use the third-party software, the Designated Agency Ethics Official (DAEO) may permit the employee to provide the required information through another means.

Furthermore, the SEC is also proposing to revise transaction deadlines by modifying the five-business day reporting requirement. The OEC (Office of Ethics Counsel) hopes that the third-party automated system will provide trade notifications sooner than the five-day

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[1] Rob Redford, https://www.sec.gov/comments/s7-02-23/s70223-325891.htm; Anonymous SEC Staffer, https://www.sec.gov/comments/s7-02-23/s70223-327139.htm; Current Employee, https://www.sec.gov/comments/s7-02-23/s70223-326825.htm

[2] https://www.sec.gov/comments/s7-02-23/s70223-327218.htm

requirement and will also allow the DAEO to require earlier reporting for SEC employees using a third-party software system. This proposal has been brought up because of the number of private corporations that have shifted to automated software systems to provide direct notification of securities transactions from an individual's broker/financial institution.

The Clinic agrees with the OEC that the integration of a third-party software system would reduce the risk of human error and oversight into the reporting and reviewing of securities holdings and transactions. Furthermore, this proposal will also reduce the burden on employees and compliance staff. However, the Clinic has three primary concerns with this proposal: 1) the invasion of privacy concerns relating to brokerage/financial institutions, 2) the responsibility on employees to comply with the reporting requirement, and 3) the prospective change to the five-day requirement.

It may be unduly burdensome for brokerage and financial institutions to attach a third-party software to their own systems due to invasion of privacy concerns. Even though this software is provided by a government entity, this does not guarantee that this software could not be hacked or broken into, resulting in massive breaches of personal user data. Furthermore, brokerage or financial institutions may not want third-party software attached to their systems, with the concern that the government is collecting personal user and company data. Several commenters highlight their privacy concerns, with one user citing back to the EDGAR user breach in 2018 and another user stating that it will "only increases expenses and chances for employees' personal information to be hacked."[3][4] A comment made by Anonymous user on March 9, 2023, evidences these privacy concerns, highlighting the EDGAR user breach in 2018. Another Anonymous user on March 9 also dislikes the third-party software idea, stating that it will "only increases expenses and chances for employees' personal information to be hacked." The attachment of third-party software could be government overreach and could lead to potential breaches of personal consumer data.

The shortening of the five-day reporting requirement will impose uneven liability on individuals who have obtained consent from their brokerage institution to implement the third-party software compared to individuals who must manually report. Furthermore, imposing a shorter deadline on individuals who must manually report would be counterintuitive to the current policy of the five-day reporting requirement.

Finally, this is particularly relevant when considering employees are responsible for complying with the reporting requirement. Individuals who have not received consent from their brokerage/financial institutions will still held accountable for not complying with the shorter reporting requirement, even though they must submit their transaction information manually. A likely solution to this problem would be to impose different reporting requirements on individuals who have not received consent from their brokerage/financial institutions versus

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[3] https://www.sec.gov/comments/s7-02-23/s70223-327178.htm
[4] https://www.sec.gov/comments/s7-02-23/s70223-327179.htm

those who have. Additionally, Eileen Parlow, a current SEC employee, questions if the automated reporting system would be mandatory or optional, as the SEC does not specify.[5]

One additional concern the Clinic has is in relation to employees being both responsible for abiding with the reporting requirement and having the brokerage and financial institution act as an agent transmitting information. The Clinic questions how the employee/member will know that the information has been reported from the agent (brokerage institution) to the OEC. It is not fair to impose a reporting requirement on the employee if there is no way for an employee to find out that their transactional information has been transmitted from the brokerage institution to the OEC. A comment echoes this sentiment, stating that "[t]he proposal provides no detail on how an employee would be able to audit the 'third-party automated compliance system' or view what information it provides to OEC."[6]

D. Prohibiting Purchases of Direct Listed Assets Will Efficiently Preserve the Integrity of Securities Market and the Trust of the Public in the Securities Market.

The SEC proposes to expand the limitation of the regulation to prohibit member or employee of the SEC to purchase securities directly listed to an exchange for seven calendar days after the direct listing effective date. The Clinic believes that this proposal is sufficient to preserve the integrity of securities market and the trust of the public in the securities market. Therefore, the Clinic strongly supports this proposal.

The SEC expressed its willingness to enhance the integrity of capital markets by further guarding against the perception of improper use of nonpublic information by SEC employees to bolster investor confidence in capital markets. The current proposal is in line with the recent measures taken by the SEC to fight insider trading, and notably with the first and second proposals.[7] Further, the SEC plays a crucial role in the promotion and maintenance of investor confidence in the fairness and integrity of the market. Therefore, it is important that the SEC maintains a high level of ethical conduct and integrity through ensuring that its employees avoid even the appearance of improper use of nonpublic information. Overall, the prohibition is consistent with the SEC's mission to protect investors and maintain fair, orderly, and efficient markets.

Although insider trading committed by SEC employees in recent years is relatively small, the public's perception of improper use of nonpublic information by SEC's employees, even if not

[5] https://www.sec.gov/comments/s7-02-23/s70223-326930.htm
[6] https://www.sec.gov/comments/s7-02-23/s70223-325891.htm
[7] *See* Statement on the Final Rule: Insider Trading Arrangements and Related Disclosures, U.S. Sec. & Exch. Comm., (Dec. 14, 2022), https://www.sec.gov/news/statement/uyeda-insider-trading-20221214; *See also* Andrew Ramonas, *SEC Toughens Insider Trading Rules for Execs, Limits Protections*, BLOOMBERG LAW, (Dec. 14, 2022), https://www.bloomberglaw.com/bloomberglawnews/securities-law/X7EKK99S000000?bna_news_filter=securities-law#jcite (mentioning SEC's rules that will require company directors and officers to wait for a cooling-off period of at least 90 days between when they schedule a trade and sell their shares); *See also* SEC Strenghens Investor Protections Against Insider Trading, GUNDERSON DETTMER, (Jan. 5, 2023), https://www.gunder.com/news/sec-strengthens-investor-protections-against-insider-trading/ (summarizing the final rules adopted by the SEC).

substantiated, may have several negative impacts. This may directly impact the investors' perception of the SEC, and therefore undermine its authority and ability to effectively regulate the markets.

The expansion of the prohibition is rightly justified by the proximity between direct listings and IPOs. Although direct listings do not involve an underwriting process like IPOs, they are both similar in term of timeline and disclosures requirements. Further, both involves high-risk investments, which has a higher potential to harm investors and to cause market distortion. In both proceedings, a significant amount of information must be disclosed to potential investors. SEC employees may have access to material nonpublic information not yet available to the public.

It may be argued that prohibiting SEC's employees from purchasing direct listed assets infringes on their personals right to invest and manage their own finance. However, this potential critic may not outweigh the benefits of the proposed rule. Further, the SEC's employees' personal rights to engage in certain trading activities must be balanced against the broader public interest in fair and transparent market.

The Clinic disagrees with the comment of a spouse of an SEC employee.[8] The commenter argues that the proposal affects the spouse's personal investing activity, despite not being an SEC employee. While the commenter may not be privy to non-public information related to their spouse's work, the proposal intends to avoid any appearance of impropriety. Even if the spouse does not intend to use nonpublic information, the mere appearance of impropriety can damage public confidence in the integrity of the securities industry and the SEC's regulatory function. Indeed, the public may legitimately believe that a SEC employee spouse may use their position for personal gain.

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[8] *See* WebForm Comments from SEC Spouse From: SEC Spouse: Affiliation: Associate, Simpson Thacher, https://www.sec.gov/comments/s7-02-23/s70223-327182.htm.

Conclusion

We respectfully request that the SEC take our comments into consideration in addressing the Proposed Rules.

Respectfully submitted,

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