

## MEMORANDUM

**TO:** All Examination Staff  
**FROM:** Lori Richards, Director  
John Walsh, Senior Adviser  
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Office of Compliance Inspections and Examinations  
**SUBJECT:** The Commission's Ethics Rules And The Exam Program: Frequently Asked Questions  
**DATE:** September 8, 1997

Commission examiners frequently face ethical issues on the job. Sometimes these issues are obvious to us, such as when we are offered a gift by a registrant, though often they are more subtle, such as when a close friend works for a registrant we are examining. As Commission examiners, much like independent auditors, it is our job to determine whether registrants are complying with the law. It is critical that our judgment not be suspect, that we maintain the utmost integrity, avoid even the appearance of impropriety or conflict of interest, and that we are above reproach in everything we do. Our function as examiners depends on our credibility. For this reason, we have established certain policies specifically applicable to examiners. In many instances, these policies may be more stringent than those applicable to overall Commission staff.

This memorandum discusses the Commission's ethics rules and OCIE policies, as applied to various examination situations. This memo is designed to supplement the Commission's Ethics Manual, to draw your attention to the policies underlying the rules, and to answer some of the questions frequently asked by exam staff about ethics rules and policies. Every ethical question is different depending on the context, and there are often no "right" or "wrong" answers. Many ethical issues are judgment calls that are best resolved by consulting with your supervisor and with your Ethics Liaison Officer (a list of Ethics Liaison Officers is attached).

### **1. CONFLICTS OF INTEREST**

Generally, staff must avoid situations involving not only a conflict of interest, but also the *appearance* of a conflict. Conflicts of interest may be either financial or personal. Financial conflicts of interest arise when you work on a matter where you, your spouse, a member of your household, or an organization you belong to, may have a financial interest in the outcome of the matter. There is no *de minimis* amount. Personal conflicts of interest arise when you are asked to work on a matter involving someone with whom you or your family have a relationship. The prohibition on employee involvement in conflict situations is complete, you must either recuse yourself, terminate the conflicted relationship, or, in rare cases, you should discuss the conflict with your ethics liaison. In addition to the family relationships listed in these questions, there may be other close personal relationships with relatives and non-relatives that could create the appearance of conflict of interest. In any situation where financial relationships or responsibilities are involved, eg. acting as an executor, guardian or conservator, you should ask your supervisor or ethics liaison if the relationship raises an ethical question. The ethics rules refer to such relationships as "covered relationships."

**Question: You, your spouse, parent, dependant child, or a member of your household own shares in a mutual fund. Can you be involved in an examination of that fund or the fund complex?**

**Answer:** Generally, you may not participate in any examination of a mutual fund complex (or its adviser) in which you, your spouse, parent, dependant child, or a member of your household own shares, and must advise your supervisor that you will be recused from participating in the examination, including any work in the field, and on the report. An exception to this policy exists for money market funds, index funds, and unit investment trusts. If you, your spouse, parent, dependant child, or a member of your household own shares in a money market fund, index fund, or unit investment trust, you may examine other funds in the complex, but not the specific fund you own. In this situation, you and your supervisors should determine, in advance of the examination, whether the exam is likely to concern issues affecting the entire complex, and thus concern the funds in which you own shares. For example, if the exam will cover such things as personal trading and allocation procedures, these matters may concern all or many funds in the complex (including the money market fund, index fund or unit investment trust) and you should recuse yourself. The decision on whether to recuse or participate in such an exam should be documented in a memo to your conduct file with a cc: provided to your supervisor and Ethics Liaison Officer.

**Question: You, your spouse, parent, dependant child, or a member of your household have a brokerage account with a firm scheduled to be examined. Can you participate in the exam?**

**Answer:** If you are scheduled to conduct an examination of the firm's headquarters, involving issues affecting the whole firm, such as internal controls, sales practice compliance, or supervision, you should tell your supervisor about the account and recuse yourself from the examination. This is necessary since a firm wide examination may include issues that directly or indirectly affect your account. The firm wide examination also may lead to a review of branch files. If you are scheduled to conduct an exam of a branch other than the one where you hold your account, you should inform your supervisor of the account. The supervisor should assign other, non-conflicted staff to conduct the examination. Additionally, you cannot participate in a broker-dealer examination of the brokerage firm office or branch that holds your brokerage account, or that holds the account of your spouse, parent, dependant child, or member of your household. You can, however, participate in a mutual fund/investment adviser/transfer agent examination of an affiliated entity. Likewise, if you, your spouse, parent, dependant child, or a member of your household own shares in a mutual fund, you may not participate in an examination of the mutual fund or its adviser, though you may participate in an examination of an affiliated broker-dealer or transfer agent.

**Question: Your spouse works for a law firm that has a client that is being examined. You are aware that your spouse's firm represents the registrant. May you participate in the examination?**

**Answer:** No. Even if your spouse is not directly involved with the firm's representation of the client, you should inform your supervisor of the possible conflict and recuse yourself. If your spouse is not a lawyer, but works in some other

capacity at the firm, you should discuss the situation with your ethics liaison. This also applies to all members of your household and other covered relationships.

**Question: A family member works in a clerical capacity at a registered entity. Can you be involved in an examination of that entity?**

**Answer:** Generally, if a member of your household, parent, spouse, dependant child or a relative with whom you have a close personal relationship is employed by a registered entity, you should recuse yourself from the examination. As to a more distant family member or close friend, generally, the closer the relationship, the more recusal should be considered. As examiners, we must not only be impartial, but must appear to be impartial at all times, therefore, if the presence of a friend at the registrant may even appear to affect your impartiality, you should discuss it with your ethics liaison. Generally, you should discuss any potential for an appearance of a conflict of interest with your supervisor and Ethics Liaison Officer first, and document whatever decision is made.

## **2. GIFTS AND OTHER GRATUITIES**

The general policy is that Commission employees may not accept gifts given to them in their official capacity. There are several exceptions and exclusions to this policy. Excluded from the prohibitions are items of little intrinsic value, such as holiday cards, coffee, soft drinks, donuts and other similar minimal refreshments. The exceptions are for gifts and other gratuities under \$20 in value. As a policy matter, however, examiners should be extremely conservative in accepting anything from a registrant.

**Question: You are on an examination of a registrant (broker-dealer, adviser, investment company, SRO, etc.). On the first day you are told that there is a cafeteria where you can get coffee, tea, soft drinks and donuts at no charge. Can you accept this offer?**

**Answer:** You may accept beverages, but you should not accept food of any kind (of course, never accept an alcoholic beverage while on an exam). While the general provisions of the ethics rules would allow acceptance of minimal refreshments, in the context of an examination, where your actions can have a direct impact on the registrant, it is vitally important that examiners avoid even the appearance of impropriety.

**Question: You are on an examination, your contact at the registrant suggests that you join him for lunch at his expense at a local restaurant. Can you accept?**

**Answer:** No. In the context of an examination, any conflict or appearance of impropriety should be avoided, and socializing with a registrant while on an examination may raise appearance issues. Therefore, prudence dictates that you should decline both the invitation to lunch and the offer to pay for the lunch. If the invitation is to eat in an in-house dining facility, you may eat there, but you should pay for your own meal. You may pay at whatever rate is charged generally to the registrant's employees using the facility.

**Question: After concluding the on-site portion of an examination, as you are leaving for the airport, the registrant's compliance officer suggests that you use the company car or limo service, or says they have people "going that way" and could drop you at the airport. Can you accept?**

**Answer:** No. The \$20 rule applies here, so in most cases, the cost of the ride would dictate refusal of the invitation. Sharing the ride might be harder to determine since the cost could be under \$20, however, appearances count. In light of the appearance issue, it is best to refuse the offer and take a cab.

**Question: During the planning stages of an examination, the registrant's chief financial officer mentions that business guests of the registrant frequently use a local hotel, and offers to get a good rate for you there, or to make the reservation for you. Can you accept this offer?**

**Answer:** No. This offer, although it appears innocuous, is a favor that raises an appearance of a conflict of interest and so should be refused. If the chief financial officer merely gives you names of local hotels, however, you may use those names to reserve your own accommodations at the government rate.

**Question: You are attending a conference where many of the other attendees are regulated entities. Can you accept invitations to cocktail parties or dinners?**

**Answer:** The general rule is that if the party or dinner is open to all attendees, and is included in the cost, you may attend, with the approval of your Office Head, Division Director or Regional Director. You must document the decision to attend and obtain the concurrence of your Regional Director, Division Director, or Office Head who will determine if concurrence needs to be oral or written (the Ethics Manual contains a sample form). You should not attend smaller dinners, parties, or other social gatherings sponsored by regulated entities that are only open to select invitees. When in doubt, always discuss the matter with your Ethics Liaison Officer.

### **3. EMPLOYMENT**

The Ethics Manual provides guidelines for Commission staff seeking outside employment with the securities industry. Generally, if the examiner is not working on any matter involving the prospective employer, the examiner can negotiate employment with a registrant. However, if the examiner is working on an examination of the registrant, the examiner cannot discuss employment. If an examiner is discussing employment opportunities with a registrant and is then assigned to an exam of that registrant, the examiner should recuse him/herself from the exam. Recusal issues should be resolved *before* the examination starts. In any case, when a Commission employee is seeking or negotiating with a regulated entity for employment, supervisors should be notified as early as possible so that conflicts or appearances of conflicts of interest can be avoided, and these discussions should be documented.

**Question: You are on an examination and become aware that the registrant has a job opening that would suit you perfectly. Can you pursue the position?**

**Answer:** During an examination you should not indicate to the registrant your interest in a position with the registrant. Seeking employment with the registrant at this time gives a strong appearance of impropriety. Actual negotiation for a position while continuing on the examination would be illegal. If the registrant suggests that there may be a position for you, it would be most prudent to tell them you are not interested at this time. If you previously informed the registrant of your search, and/or had begun to discuss employment with the registrant, you should have recused yourself from the examination completely and informed your supervisor of the reason. If you had recused yourself, you could continue discussions with the registrant. If you are a supervisor, your supervisor should appoint someone else to supervise the examination.

**Question: Just after completing the field portion of an examination, but prior to writing the report, a head hunter you were dealing with calls to say the registrant has an opening that would be perfect for you. Can you follow up on this?**

**Answer:** No. If you are interested in discussing employment with the registrant, you must immediately inform your supervisor. You should not follow-up on this possibility until the examination is completely over and any deficiency letter or report is completed and the registrant has responded. When the examination is complete you may call the head hunter and proceed with the employment discussions.

**Question: You have been at the Commission one year or more, and have been assigned to examine your old employer. Should you recuse yourself?**

**Answer:** Perhaps. If the examination is a general exam, and not specific to an area that was your responsibility at the registrant, after one year you may be involved in the examination. If the exam is in an area that you were involved with, you should recuse yourself. If the examination is not directly of the entity you worked for, but of another registrant in the same complex or holding company, you may complete the examination.

**Question: What should you do if: (1) your spouse is employed at the registrant you have been assigned to examine or is currently negotiating for a position with that registrant or; (2) just after completing an examination, your spouse informs you that he or she is negotiating employment with the registrant you just examined?**

**Answer:** You may not examine the entity that employs your spouse, or any one considered a covered relationship. In addition, if your spouse, or some one who is in a covered relationship is actively seeking or negotiating employment with the registrant, or has done so recently, you should recuse yourself.

#### **4. DISCLOSURE OF NON-PUBLIC INFORMATION**

Non-public information obtained as a result of your employment at the SEC should never be disclosed publicly or to anyone outside the agency absent supervisory

approval. Breaches are extremely serious, and may violate the federal securities laws, as well as federal ethics laws and rules.

**Question: You have just completed an examination, and are at a restaurant with fellow employees. Another staff member asks how the examination went. What can you say?**

**Answer:** A restaurant is a very public place; an examination is a non-public matter. In any public place you should be very careful not to mention the name of the registrant or give any other information that could be used to identify the registrant.

**Question: You are revising your resume, can you disclose the names of some of the registrants you have examined?**

**Answer:** Information on the identity of specific registrants examined is non-public and may never be disclosed absent supervisory approval, and certainly not in a resume.

**Question: You are telephoned by a reporter for a newsletter that frequently reports on examinations, and asked about a general policy that you know the Commission is taking in its exams. Should you discuss this with the reporter?**

**Answer:** No. Information about specific examinations and even about general policies surrounding the exam program may be non-public. To assure that non-public information is not inadvertently disclosed, you should state that it is the Commission's policy not to comment on examinations, and refer the call to your Assistant Director for a response.

## **5. TRAVEL**

The nature of the job requires that examiners are often "on the road." It is important to remember that when on official travel, examiners are still on the job and must comport themselves appropriately and in a manner that reflects a favorable public image of the Commission's examiners. Inappropriate or obnoxious behavior while on an exam, even when after hours, can reflect poorly on the Commission.

**Question: You are flying to a distant city to start an examination the following day. Can you drink excessively on the plane, yell at the flight attendants, wear inappropriate clothing and pad your claimed expenses?**

**Answer:** Obviously this behavior reflects unfavorably on the public image of the Commission's examiners. At all times during the course of an examination, from the moment the examiner leaves the SEC office until he/she returns, the examiner should ensure that he/she acts in a manner that reflects a positive image of the Commission's examination staff. Padding expenses, of course, is both unethical and illegal.

We hope that this information will be helpful to you in resolving ethical issues as they arise. If you have questions, please contact your Ethics Liaison Officer, your OCIE Liaison, or an ethics counsel in the Commission's Ethics Office.