



United States Office
Of Government Ethics

Report Number 08-011

Ethics Program Review

Securities and Exchange Commission

July 2008 Report

Introduction

OGE MISSION

The U.S. Office of Government Ethics (OGE) provides leadership for the purpose of promoting an ethical workforce, preventing conflicts of interest, and supporting good governance initiatives.

PURPOSE OF A REVIEW

The purpose of a review is to identify and report on the strengths and weaknesses of an ethics program by evaluating: (1) agency compliance with ethics requirements found in relevant laws, regulations, and policies and (2) ethics-related systems, processes, and procedures in place for administering the program.

REVIEW AUTHORITY AND SCOPE

OGE has the authority to evaluate the effectiveness of executive agency ethics programs. *See* Title IV of the Ethics in Government Act of 1978, as amended (the Ethics in Government Act), and 5 CFR part 2638. OGE's review of the Securities and Exchange Commission (SEC) focused on the elements listed below.

- Program structure
- OGE administered employee survey
- Supplemental Standards of Ethical Conduct
- Financial disclosure systems
- Ethics education and training
- Ethics agreements
- Ethics counseling
- Enforcement of ethics laws and regulations
- Federal advisory committees
- Travel payments from non-Federal Sources

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OGE's review focused on the ethics program at SEC headquarters and was conducted in April 2006. OGE suggests that SEC headquarters' ethics officials instruct regional offices to review this report.

Program Elements

This report consists of descriptions, analyses, and conclusions regarding each program element reviewed.

PROGRAM STRUCTURE

SEC's ethics program is administered by the Ethics Office within the Office of the General Counsel. The Ethics Counsel serves as the Designated Agency Ethics Official (DAEO). The General Counsel serves as the Alternate DAEO. Additionally, a Paralegal, a Management Analyst for Financial Disclosure, an Ethics Research Assistant, and four Assistant Ethics Counsels serve specific functions within the Ethics Office.

In addition to the ethics staff in the Ethics Office, approximately 60 managerial employees serve as ethics contacts on a part-time basis. These employees act as Ethics Liaison Officers or Deputy Ethics Liaison Officers serving within headquarters, regional, and district offices. They primarily respond to ethics-related questions from their respective offices' employees or direct questions to SEC's Ethics Office for response, as necessary.

OGE-ADMINISTERED EMPLOYEE SURVEY

OGE conducted a survey of the employees at SEC in June 2005. The purpose of the survey was to assess SEC's ethics program and ethical culture from the employees' perspective. The population for the survey was all Government employees who work for the SEC¹. Overall, employees who responded to the survey were favorable in their assessment of SEC's ethics program and ethical culture. Most of the respondents indicated that they were familiar with the rules of ethical conduct for executive branch employees and were aware that there are ethics officials in their agency with responsibility for addressing ethical concerns. Additionally, most respondents indicated that the ethics advice, education, and training they received were useful in making them more aware of ethics issues and guiding their decisions and conduct in relation to their work.

SUPPLEMENTAL STANDARDS OF ETHICAL CONDUCT

SEC has indicated that it will seek to issue a supplemental regulation under the authority of 5 CFR § 2635.105 granting executive branch agencies the ability to publish agency-specific supplemental regulations that are necessary to implement an agency's ethics program. The supplemental regulation would include provisions regarding prohibited financial interests and

¹ OGE sent e-mail invitations to participate in the survey to 3,640 employees. OGE received 1,342 responses, for a response rate of 37%.

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securities, plus a requirement that SEC employees obtain prior approval before engaging in outside employment or activities and before engaging in financial transactions. SEC plans to provide OGE, for its concurrence and joint issuance, a copy of the proposed supplemental regulation in the summer of 2008, with a goal of publishing the supplemental regulation early in fiscal year 2009.

FINANCIAL DISCLOSURE SYSTEMS

Title I of the Ethics in Government Act requires that agencies ensure confidence in the integrity of the Federal Government by demonstrating that officials are able to carry out their duties without compromising the public trust. High-level Federal officials demonstrate that they are able to carry out their duties without compromising the public trust by disclosing publicly their personal financial interests (SF 278). Title I also authorizes OGE to establish a confidential financial disclosure system for less senior executive branch personnel in certain designated positions to facilitate internal agency conflict of interest review (OGE Form 450).

Financial disclosure serves to prevent conflicts of interest and to identify potential conflicts by providing for a systematic review of the financial interests of both current and prospective officers and employees. The financial disclosure reports also assist agencies in administering their ethics programs in providing counseling to employees. *See* 5 CFR § 2634.104(b).

SEC has comprehensive written procedures for the administration of the public and confidential financial disclosure systems. Effective written procedures allow for accurate and consistent administration of financial disclosure systems and are a necessary element of succession planning. However, OGE determined that a significant percentage of new entrant confidential financial disclosure reports were not filed in a timely manner. During the onsite fieldwork portion of the review, SEC advised the OGE review team that it has implemented specific actions to address the timely filing of confidential financial disclosure reports. The actions are summarized in the below Confidential Financial Disclosure System section of this report.

Public Financial Disclosure System

The administration of the public financial disclosure system is primarily the responsibility of the Management Analyst for Financial Disclosure, SEC's DAEO, and the Assistant Ethics Counsels. The Management Analyst for Financial Disclosure conducts a technical and substantive review of the reports. After the review is completed, the report is forwarded to an Assistant Ethics Counsel, who then conducts a second-level substantive review. If the Assistant Ethics Counsel has no questions and has signed the report, the report is forwarded to the DAEO for review and certification. During each step of the review process, the Ethics Research Assistant updates an assignment log to record the date on which each reviewer received the report.

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To evaluate the filing, review, and certification of public reports at SEC, OGE examined 36 out of the 139 public reports required to be filed in 2005 at SEC headquarters. These 36 reports consisted of:

Type of Report

- 11 annual reports
- 20 new entrant reports
- 4 termination reports
- 1 incumbent/termination report

36 total

Filing Timeliness

- All 36 reports were filed timely.

Review Timeliness

- All 36 reports were reviewed timely.

Certification Timeliness

- All 36 reports were certified timely.

Quality of Review

SEC's public financial disclosure report files reflected that the reports had been systematically reviewed. OGE noted that the majority of the reports included annotations by reviewing officials. When appropriate, recusal memoranda were attached to the reports.

Public Reports filed by Presidentially-appointed, Senate-confirmed Employees

Ten of the 139 public reports required to be filed at SEC in 2005 were filed by Presidentially-appointed, Senate-confirmed (PAS) employees. In addition to reviewing a sample of 36 public reports filed by non-PAS filers, OGE confirmed that all 10 PAS reports were reviewed and submitted timely to OGE.

Confidential Financial Disclosure System

SEC's confidential financial disclosure system is decentralized. The review and certification of confidential reports is the responsibility of Division Directors, Office Heads, Regional Directors, and District Administrators. However, authority to review the confidential reports can be delegated to a lower level, when appropriate. To protect an employee's privacy, SEC discourages delegating review authority to the employee's immediate supervisor. In cases

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in which a reviewing official believes that the sensitive nature of an employee's work assignments might be more likely to create a potential conflict, the reviewing official may request an intermediate review by the employee's immediate supervisor or other individual who is familiar with the employee's work assignments. When the reviewing official is satisfied that the report is complete and in compliance with applicable statutes, regulations, and executive orders, the reviewing official signs the report as the final reviewer.

To evaluate the confidential financial disclosure system at SEC, OGE examined 87 out of the approximately 2,341 confidential reports required to be filed by SEC headquarters' employees in 2005. These 87 reports consisted of:

Type of Report

- 26 annual reports
- 61 new entrant reports

87 total

Filing Timeliness

- 69 reports were filed timely.
- 18 reports were filed late.

87 total

Late filing of financial disclosure reports diminishes an agency's ability to provide timely and specific advice regarding conflicts of interest, which is a fundamental purpose of any ethics program. Accordingly, during the review, SEC advised OGE that it had implemented specific steps to address the issue of filing timeliness. First, the Ethics Office hired a program manager to manage more closely the agency-wide confidential financial disclosure system. Second, Ethics Office staff initiated a cycle of one-on-one training sessions with staff in each of the agency offices with administrative responsibilities for the confidential system. Third, the in-person ethics orientation sessions at SEC headquarters were modified to include specific instruction to employees reminding them of their responsibility to file financial disclosure reports on time. Fourth, Ethics Office financial disclosure staff has worked (and continues to work) to improve both the periodic report data it receives from, and the routine notices it sends to, the staff responsible for administering the confidential system in the various SEC offices. Finally, SEC advised OGE that for new agency employees, the delay in the receipt of confidential reports is mitigated by an SEC conflicts review process that analyzes new employee holdings for potential conflicts with agency work. SEC stated that the conflict review process should be better integrated with the confidential financial disclosure report and that work is underway to enhance this integration.

In light of the actions SEC has taken to improve the filing timeliness of confidential reports, OGE makes no formal recommendation for improvement in this area.

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Review Timeliness

- All 87 reports were reviewed timely.

Certification Timeliness

- All 87 reports were certified timely.

Quality of Review

SEC's confidential financial disclosure report files reflected that the reports had been systematically reviewed. OGE noted that the majority of the reports included annotations by reviewing officials. When appropriate, recusal memoranda were attached to the reports.

ETHICS EDUCATION AND TRAINING

An ethics education and training program is essential to raising awareness among employees about ethics laws and rules and informing them that an agency ethics official is available to provide ethics counseling. Each agency's ethics training program must include at least an initial ethics orientation for all employees and annual ethics training for covered employees.

Each year SEC drafts an annual training plan that documents and describes the topics to be covered in the upcoming year. SEC uses model practices such as targeted ethics training for non-covered employees. For example, OGE reviewed ethics training that targeted examiners, particular offices, and even entire divisions within SEC.

Initial Ethics Orientation

Within 90 days from the time an employee begins work for an agency, the agency must provide the employee with initial ethics orientation. Initial ethics orientation must include:

- the Standards of Ethical Conduct for Employees of the Executive Branch (Standards) and any agency supplemental standards;
- the names, titles, office addresses, and phone numbers of the DAEO and other ethics officials; and
- at least one hour of official duty time to review the items described above. *See 5 CFR § 2638.703.*

All SEC employees are given an initial ethics orientation in the form of written materials and an in-person ethics briefing. The written materials and the briefing are provided typically on the first day of new employees' entrance on duty. The written materials consist of the Standards and SEC's internal policies.

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The OGE review team attended an initial ethics orientation session on June 5, 2006 and noted that SEC's ethics official covered the key ethics rules and regulations. The ethics official not only imparted general ethics-related information such as the 14 Principles of Ethical Conduct, but also discussed matters of particular interest to SEC, particularly security transaction reporting rules and non-divulgence of public information. Additionally, the ethics official outlined the structure of the Ethics Office and provided names and contact information for all the ethics officials and ethics liaisons within SEC.

OGE also reviewed a DVD that is shown at initial ethics orientation in SEC's regional offices. In addition to viewing the DVD, new regional office employees are provided with a copy of the Standards to review for an additional hour.

Initial ethic orientation is usually conducted every two weeks. The Office of Human Resources provides the Ethics Office with a list of new employees. The ethics official who conducts the orientation collects a certification² from each employee who attends. Certifications are then presented to the Ethics Research Assistant who compares them with the new employee lists. The Ethics Research Assistant is responsible for tracking orientation certifications and following up on any that are missing.

OGE's review determined that 542 employees were required to receive initial ethics orientation during the period covered by OGE's review. OGE located 487 certifications signed by new employees upon the completion of initial ethics orientation. OGE was unable to locate the remaining 55 certifications at the time of its fieldwork; however, SEC subsequently provided the remaining 55 certifications.

Annual Ethics Training

Public financial disclosure filers are required to receive verbal annual ethics training each year. *See* 5 CFR § 2638.704(a). Verbal training includes training prepared by a qualified instructor and presented by telecommunications, computer, audiotape, or videotape. *See* 5 CFR § 2638.704(c)(2). Other covered employees (e.g., confidential filers) are required to receive verbal annual ethics training at least once every three years and may receive written annual training in the intervening years. *See* 5 CFR § 2638.705(c). The content requirements for both public filers and other covered employees are the same. Agencies are encouraged to vary the content of annual training from year to year but the training must include, at least, a review of:

- the 14 Principles of Ethical Conduct;
- the Standards;
- any agency supplemental standards;
- the Federal conflict of interest statutes; and
- the names, titles, office addresses, and phone numbers of the DAEO and other ethics officials. *See* 5 CFR § 2638.704(b).

² Certifications are provided to all new employees in their orientation package.

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All 10 PAS employees required to receive annual ethics training received it. In 2005, 129 non-PAS public filers appeared to have been required to receive annual ethics training; however, only 89 non-PAS public filers actually received training. SEC explained the discrepancy in as reflecting non-PAS public filers who terminated their employment with SEC prior to the scheduled training sessions. All OGE Form 450 filers received annual ethics training.

SEC broadcasts live training sessions held at headquarters to the regional offices. Attendees at the regional offices have the ability to communicate with the ethics officials providing the training. The live broadcast is recorded in order to maintain a record and to use at make-up sessions. OGE reviewed a video of one of these sessions. OGE noted the active participation in discussions by senior-level SEC officials.

In addition to providing annual ethics training for covered employees, SEC provides ethics training to certain non-covered employees. For example, SEC provided tailored training to the Office of Compliance Inspections and Examinations and the Enforcement Division. OGE recognizes this training for non-covered employees as a model practice.

In addition to its formal ethics training, SEC provides bi-weekly NewsGrams regarding various ethics-related issues that are posted prominently on the SEC Intranet home page and e-mailed directly to all employees. The NewsGrams are also maintained in the archives to the Intranet home page and on the Intranet ethics page.

ETHICS AGREEMENTS

If potential or actual conflicts of interest exist, public and confidential financial disclosure filers may be required to enter into ethics agreements. Generally, employees entering into ethics agreements are required to comply with those agreements within three months of the agreement or of Senate confirmation, if applicable. *See* subpart H of 5 CFR part 2634.

There were nine written ethics agreements entered into by PAS employees in 2005. The agreements, which required the employees to execute recusals or divestitures, were carried out in accordance with applicable regulations and the terms of the agreements. OGE received evidence of compliance from SEC for those employees who entered into ethics agreements in 2005.

SEC advised OGE that it has implemented a comprehensive system to integrate the PAS employee conflicts considerations throughout the agency's work. Ethics Office staff reads every official document, such as proposals for an investigation, enforcement action, or rulemaking, before the documents are presented to members of the Commission for action, in order to evaluate them for potential conflicts with members of the Commission and certain senior members of the staff. In order to perform this review, Ethics Office staff use a record of recusal data maintained and updated monthly by the Office of the Secretary, other information provided to the staff by members of the Commission and senior staff, and knowledge of agency business. Ethics Office staff often contact individuals responsible for particular projects in order to clarify potential links among other ongoing matters, the identity of counsel or auditing firms whom certain members of the Commission or senior staff may have a conflict, as well as the identity of putative harmed investors. These contacts sensitize agency staff to the ongoing vigilance to

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protect the integrity of the agency's work and to the need to monitor their own potential conflicts.

Records of recusals by members of the Commission are maintained by the Office of the Secretary. Moreover, the Ethics Office maintains a searchable record of recusals by both members of the Commission and certain senior staff, noting the reasons for the recusals, which facilitates future review of the same and other matters.

ETHICS COUNSELING

The DAEO is required to ensure that a counseling program for agency employees concerning ethics and standards of conduct matters, including post-employment matters, is developed and conducted. *See* 5 CFR § 2638.203. The DAEO may delegate to one or more deputy ethics officials the responsibility for developing and conducting the counseling program. *See* 5 CFR § 2638.204.

OGE's assessment of an ethics counseling program focuses on five factors: (1) accuracy, (2) timeliness, (3) transparency, (4) accountability, and (5) consistency. To determine whether an agency's counseling program successfully addresses these factors, OGE reviews and assesses the program's processes and written procedures. Further, OGE reviews selected samples of advice to assess whether processes and written procedures are effective.

To meet the counseling requirements at SEC, ethics-related counseling is provided to SEC employees by SEC's ethics officials. SEC employees can seek ethics counseling as needed by sending questions to ethics@sec.gov. This e-mail address collects all ethics inquiries which any SEC ethics official can view and respond to. SEC ethics officials discuss opinions prior to providing guidance to SEC employees. In addition, to ensure counseling is rendered accurately, SEC ethics officials review written opinions randomly, conduct periodic discussions among themselves, and consult with the DAEO on all statutory conflict of interest concerns and other more significant issues.

To evaluate the counseling provided, OGE examined a sample of approximately 60 written determinations rendered during the period covered by the review. The majority of the advice was in the areas of gifts, seeking employment, impartiality, and post-employment. OGE's review of the written determinations found the counseling rendered therein to be accurate and consistent and to be rendered in a timely manner.

ENFORCEMENT

The DAEO is required to ensure that (1) information developed by internal audit and review staff, the Office of the Inspector General, or other audit groups is reviewed to determine whether such information discloses a need for revising agency standards of conduct or for taking prompt corrective action to remedy actual or potential conflict of interest situations and (2) the services of the agency's Office of the Inspector General are utilized when appropriate, including the referral of matters to and acceptance of matters from that Office. *See* 5 CFR § 2638.203(b)(11) and (12).

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According to SEC's Office of Inspector General (OIG), two alleged conflict of interest violations were referred to the Department of Justice (DOJ) in calendar year 2005. In one instance, an employee was counseled and divested of the prohibited holdings that gave rise to the allegation. In the other instance, the outcome was pending at the time of OGE's review.

Both the Inspector General and the Ethics Office officials are aware of the requirement to concurrently notify OGE of referrals to DOJ of alleged violations of the criminal conflict of interest laws as well as subsequent disposition reports. *See* 5 CFR § 2638.603(b). However, OGE was not notified of the referral of the two cases noted above nor of DOJ's final decision to not prosecute either of the two cases.

According to SEC, the supervisory staff in OIG has sent a message to its staff reminding them of the requirement to notify OGE concurrently with DOJ of any conflict of interest referral and must notify OGE of any subsequent DOJ decision on prosecution, as well as any disciplinary action planned or taken by the agency.

In calendar year 2005, SEC had seven alleged violations of the Standards. Of the seven instances of alleged violations of the Standards; five employees resigned, one employee was counseled, and one agreed to retire.

SEC's Ethics Office officials and SEC's Inspector General indicated that there is an effective working relationship between their two offices. The relationship ensures that information developed by OIG regarding alleged ethics violations is shared with ethics officials. OIG would make any required referrals to DOJ.

FEDERAL ADVISORY COMMITTEE

SEC has one Federal advisory committee, the Advisory Committee on Smaller Public Companies. SEC established the advisory committee to assess the current regulatory system for smaller companies under the securities laws, including the impact of the Sarbanes-Oxley Act of 2002. The Ethics Office deemed that all members of the Advisory Committee on Smaller Public Companies serve as representatives, rather than special Government employees, and thus are not subject to Federal ethics laws and regulations.

ACCEPTANCE OF TRAVEL PAYMENTS FROM NON-FEDERAL SOURCES

An employee may accept payment of travel expenses from non-Federal sources on behalf of the employee's agency for official travel to a meeting or similar function when specifically authorized to do so by the agency. Agencies must submit semiannual reports of travel payments from non-Federal sources in excess of \$250 to OGE. *See* 31 U.S.C. § 1353.

SEC accepts travel payments from non-Federal sources for travel, subsistence, and related expenses incurred by agency employees on official travel for attendance at a meeting or similar function under the authority of 31 U.S.C. § 1353. The procedures for requesting authorization for acceptance of travel payments from a non-Federal source are detailed in the SEC Administrative Regulations section of SEC's Intranet Web page. The Office of Financial

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Management (OFM) is responsible for maintaining the agency's official payment records and collection-related documentation for travel payments from a non-Federal source. OFM is also responsible for submitting semiannual reports to OGE.

OGE examined all 91 of the payments that were accepted under the authority of 31 U.S.C. § 1353 during the period of April 1, 2005 through September 30, 2005. The semiannual report covering this period was sent to OGE in a timely manner. Of the 91 payments examined, OGE found that 87 had been reviewed and authorized prior to the occurrence of travel. However, OGE identified four instances where travel occurred prior to written authorization. Nonetheless, a conflict of interest analysis had been conducted in each of the four instances *prior* to travel occurrence and no conflicts of interest were identified. Ethics officials stated that conflict of interest analyses are a routing part of the approval process.

Summary

OGE's review identified a model practice that the SEC has implemented: providing annual ethics training to non-covered employees.

OGE's review identified two areas of deficiency relating to SEC's new entrant confidential financial disclosure system and its procedures for concurrently notifying OGE of referrals to the Department of Justice and subsequent disposition reports. However, during and since OGE's on-site fieldwork, SEC took several actions to rectify these deficiencies. Therefore, OGE makes no formal recommendations for improvement in SEC's confidential financial disclosure or referral procedures.

If you have any comments or would like to discuss this report, please contact Dale Christopher, Associate Director for Program Reviews, at 202-482-9224.