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COMMITTEE ON ETHICS

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MEMORANDUM TO ALL HOUSE MEMBERS, OFFICERS, AND EMPLOYEES

FROM: Committee on Ethics **JB**
Jo Bonner, Chairman
Linda T. Sánchez, Ranking Member **AS**

SUBJECT: New Ethics Requirements Resulting from the STOCK Act

The purpose of this memorandum is to summarize the new rules and clarifications put in place by the enactment of the Stop Trading on Congressional Knowledge Act of 2012 (STOCK Act).¹ Many of the new ethics requirements discussed below took effect on **April 4, 2012**, when the STOCK Act was signed into law. Other provisions take effect at a later date. The effective date of each change is included in the discussion below.

Provisions of the STOCK Act that affect House Members and staff include:

- Financial disclosure filers must periodically report transactions in certain securities
(Provision applies to transactions executed on or after July 3, 2012);
- Members must disclose personal residence liabilities (e.g., mortgages)
(Provision applies to Members' financial disclosure statements to be filed May 15, 2012);
- Extensions in financial disclosure matters will be disclosed on the Clerk of the House's Web site
(Provision applies to extensions granted for filings made in 2012. They will be made public not later than August 31, 2012);
- Limitations are imposed on participation in Initial Public Offerings
(Provision applies to participation on or after April 4, 2012);

¹ Stop Trading on Congressional Knowledge Act, S 2038, as enrolled, PL 112-___ (Enacted April 4, 2012) (hereinafter STOCK Act).

- All senior staff must submit employment negotiation and recusal notices (*Provision applies to negotiations commenced on or after April 4, 2012*); and
- Prohibitions on “insider trading” are clarified and re-affirmed.

DEFINITION OF SENIOR STAFF

Among other actions, the STOCK Act amends certain requirements, and adds new requirements, for Financial Disclosure (FD) filings under the Ethics In Government Act (EIGA).² Many of the requirements apply to Members and “senior staff,” as defined in the EIGA. *While these provisions have not changed, the Committee takes this opportunity to remind you that it is your responsibility to know if you are senior staff and to comply with the ethics requirements that attach to that designation.*

As a reminder, “senior staff” are those House officers and employees whose “rate of basic pay is equal to or greater than 120 percent of the minimum rate of basic pay payable for GS-15 of the General Schedule” for at least 60 days at any time during a calendar year, provided that the officer or employee “performs the duties of his [or her] position or office for a period in excess of sixty days in that calendar year.”³ For CY 2011 and CY 2012 the annual threshold rate of pay is **\$119,553.60**,⁴ or a monthly salary at or above \$9,962.80. If your gross base salary was raised above the senior staff rate, \$9,962.80, for any two months⁵ in a calendar year then you are senior staff for that calendar year for FD purposes. This often happens when House employees are awarded year-end bonuses that are paid out over two paychecks.

PERIODIC TRANSACTION REPORTS

In general, FD filers must report on their annual FD filing each purchase, sale, or exchange transaction involving real property, stocks, bonds, commodities futures, or other securities made by the filer, their spouse, or dependent child when the amount of the transaction exceeds \$1,000. For sales transactions, the \$1,000 threshold is based on the total dollar value of the transaction, not the gain or loss made on the sale.

Section 6 of the STOCK Act now requires Members, officers, and employees who file annual FD Statements pursuant to the EIGA to also file periodic reports of certain

² Ethics In Government Act (EIGA), 5 U.S.C. app. 4 §§ 101 *et seq.* Hereinafter all citations to the EIGA will be to the appropriate federal code citation.

³ 5 U.S.C. app. 4 §§ 109(13) & 101(d). In addition, all House Members are required to file FD statements. 5 U.S.C. app. 4 §§ 101(e)-(f).

⁴ This amount is referred to as the “senior staff rate.”

⁵ The House payroll department operates on a 30-day payroll cycle, meaning that each monthly pay period, regardless of its actual length, is counted as 30 days. Thus, a change to an employee’s base rate of pay in any two months during the calendar year (even non-consecutive months) may trigger the requirement to file a Financial Disclosure Statement. This is true even if the pay change affects only part of a month.

personal financial transactions in stocks, bonds, and other securities. As a result, Members and officers and employees who are senior staff must file Periodic Transactions Reports (PTR) for transactions that are executed on or after **July 3, 2012**.⁶ The requirement to file PTRs also applies to House employees who are not paid at the senior staff rate but are required to file an annual FD because they were designated to file as a principal assistant by their employing Member. A PTR must be filed within 30 days of the filer's receiving notice that a reportable transaction has been made, but no later than 45 days after the transaction has occurred.

As a general matter, all securities transactions that are already reportable on an annual FD Statement must now also be reported on a PTR, with certain exceptions, as described below.

Exception: You are not required to file a PTR for transactions in a widely held investment fund (e.g., a mutual fund or exchange traded fund) if:

1. You neither exercise control over nor have the ability to exercise control over the financial interests held by the fund, and
2. The fund is publicly traded or the assets of the fund are widely diversified.

A fund is widely diversified if it both:

1. Holds no more than 5% of the value of its portfolio in the securities of any issuer (other than the U.S. government), and
2. Holds no more than 20% of the value of its portfolio in any particular economic or geographic region.⁷

Note that while transactions in these types of securities do not have to be reported on a PTR, ***they must still be reported on your annual FD Statement.***

Also note that purchase and sales transactions involving assets held within self directed retirement accounts such as 401(k) plans and IRAs must be disclosed on both a PTR and your annual FD Statement if they exceed \$1,000 in value or generate more than \$200 in income for any one asset. For example, if you have a 401(k) plan and direct the plan administrator to sell your entire \$10,000 holding in "Mega Corporation" stock and purchase shares in "Zoro Company" stock you must separately disclose each of these transactions on the transactions report. Likewise, the reallocation of funds among currently-held assets within these accounts are also considered purchase and sales transactions and must be disclosed.

The reporting threshold for disclosure of transactions is reached when the *gross* amount of either a single purchase or sales transaction exceeds \$1,000. *This includes transactions that result in a net loss.* Thus, a sales transaction of an asset for \$5,000 for

⁶ 5 U.S.C. app. 4 §§ 101(c), 109(f) and 103(l).

⁷ See 5 C.F.R. § 2634.310(c)(3) (2006).

which you previously paid \$7,000 must be disclosed on a PTR even though it resulted in a \$2,000 net loss.

The Committee will issue additional guidance regarding PTRs, as well as forms for use in filing a PTR, and provide additional training, closer to the date the first reports will be due.

MEMBER DISCLOSURE OF MORTGAGES ON PERSONAL RESIDENCES ON THE ANNUAL FD STATEMENT

The EIGA requires all FD filers to report any liabilities secured by real property that generates income or is held for investment purposes.⁸ To date, this requirement had exempted disclosure of any liability on real property that was used solely as a personal residence (*i.e.*, that did not generate any rental income and was not held for an investment purpose).⁹

Section 13 of the STOCK Act deletes the personal residence exception for Members. Pursuant to the STOCK Act, Members are now required to report all liabilities secured by real property that they own or that they own jointly with another person, regardless of whether or not the property generates any rental income or is held for an investment purpose. (This requirement does not apply to officers or employees.) As a result, Members now must report on Schedule V of their annual FD Statement any mortgage, home equity loan, or home equity line of credit on any property, including a personal residence. In addition to a Member's primary personal residence, this includes, but is not limited to, the mortgage on a vacation or second home or vacant piece of property. Members must report the liability at the highest amount owed during the reporting period. This reporting requirement will apply to annual reports due on or after **May 15, 2012**.

PUBLIC DISCLOSURE OF FD EXTENSIONS

The EIGA permits the Committee to grant an extension of time for the filing of any Statement required under the statute.¹⁰ Section 8(a)(2) of the STOCK Act now requires any grant of an extension to be publicly filed by the Clerk, together with the report for which the extension was granted.

Any filer seeking an extension of time to file an FD Statement should use the appropriate form created by the Committee for that purpose. Extension request forms for annual filers, PTR filers, and candidates are available on the Committee Web site (ethics.house.gov) under Financial Disclosure / Information & Forms. Instructions for completing and submitting an extension request to the Committee appear on the

⁸ 5 U.S.C. app. 4 § 102(a)(4).

⁹ 5 U.S.C. app. 4 § 102(a)(4)(A).

¹⁰ 5 U.S.C. app. 4 § 101(g).

extension request forms. The Committee will submit all granted extension requests to the Clerk for public filing. Please remember that an extension will only be granted if the request is received on or before the original due date.

LIMITATION ON PARTICIPATION IN INITIAL PUBLIC OFFERINGS

Section 12 of the STOCK Act bans Member, officers, and employees who file FD statements from participating in Initial Public Offerings (IPO) in a manner “other than is available to members of the public generally.” IPO participation, however, is often unavailable to the general public at all. This limitation took effect immediately upon enactment of the STOCK Act on April 4, 2012. If you would like to participate in an IPO, please first contact the Committee in advance to determine whether or not the purchase would be permissible.

DISCLOSURE OF EMPLOYMENT NEGOTIATIONS AND RECUSAL REQUIREMENTS

House Rule 27 requires all Members, officers, and those employees who are deemed “very senior staff” to file a statement of negotiation with the Committee within three days of entering job negotiations with a private employer. “Very senior staff” are employees of a Member, leadership, or committee office who have been paid at an annual rate of \$130,500 for at least 60 days in the past 12 months.¹¹

Section 17 of the STOCK Act extends this requirement to all employees who file a Financial Disclosure Statement pursuant to EIGA. *Thus, the requirement to file a written notice of job negotiations now applies to both senior staff and those staff designated as principal assistants, as well as to Members, officers, and very senior staff.* In addition, Members and these employees must also recuse themselves from matters where there is a conflict of interest or the appearance of a conflict and notify the Ethics Committee in writing of the recusal. This requirement took effect immediately upon enactment of the STOCK Act on April 4, 2012.

The Committee has issued forms, available on the Committee Web site (ethics.house.gov), to be used for these notification requirements. When notifying the Committee of negotiations or agreements for future employment or compensation, Members and employees should complete and sign an employment negotiation form, formally titled the “Notification of Negotiations or Agreement for Future Employment.” The original, completed form must be submitted to the Committee, but all filers should keep a copy of their submission for their records. There is a separate form for notifying the Committee of recusal, entitled the “Statement of Recusal.” As with the job negotiation form, the original Statement of Recusal must be submitted to the Committee.

¹¹ The very senior staff rate for employees of other legislative offices, such as the Architect of the Capitol, Government Accountability Office, Government Printing Office, Library of Congress, Congressional Budget Office, and Capitol Police, is \$155,500 for CY 2012.

Note that Rule 27, clause 4, requires that any Member who recuses from any action under the rule must then file the Member's Notice of Negotiations with the Clerk for public disclosure. (Officers and staff are not subject to this public disclosure requirement).

Guidance for determining when either a Notice of Negotiations or Statement of Recusal must be filed is provided in a pair of advisory memoranda (one for Members and one for House staff). The two memoranda, "Negotiations for Future Employment and Restrictions on Post-Employment" for Members or staff, are available on the Committee Web site (ethics.house.gov) under "General Advisories."

PROHIBITION AGAINST INSIDER TRADING

The Committee previously issued guidance regarding several statutes and rules that already prohibit so-called insider trading by Members and staff.¹² The STOCK Act explicitly affirms that Members and **all** employees are subject to the insider trading prohibitions arising under the securities laws, which include Section 10(b) of the Securities Exchange Act of 1934 and 17 C.F.R. § 240.10b-5 (popularly known as Rule 10b-5). The prohibition applies to information learned both in an official capacity and in a personal capacity.

As discussed in the Committee's earlier advisory memorandum, Members and employees may obtain material nonpublic information about a public company or economic sector (e.g., energy, telecommunications, or healthcare) during the course of their official duties or in their personal capacity from family, friends, acquaintances, or from their own involvement with a company. If the Member or employee chooses to trade on this information, they may have engaged in insider trading.

Material nonpublic information is any information concerning a company, security, industry or economic sector, or real or personal property that is not available to the general public and which an investor would likely consider important in making an investment decision. A good rule of thumb to determine whether information may be material nonpublic information is whether or not the release of that information to the public would have an effect on the price of the security or property.

For example, a House employee learns in a meeting with Food and Drug Administration (FDA) staff that a new miracle weight loss drug is going to be approved by the FDA. The staffer is informed at the meeting that this information is confidential. The House employee then buys shares in the company that manufactures the drug. Once the news of the drug approval is made public, the company share price increases and the employee sells at a profit. As the STOCK Act explains, the employee would be subject to liability for violation of federal civil and criminal insider trading statutes. However, if

¹² Comm. on Ethics, *Rules Regarding Personal Financial Transactions* (Nov. 29, 2011). While the Committee may issue additional guidance on these restrictions in the future, the guidance cited above is incorporated herein in satisfaction of Section 3 of the STOCK Act.

the House employee waits to purchase the shares until the information regarding the FDA decision becomes public, the employee would not be subject to liability.

Finally, Section 4 of the STOCK Act also makes clear that each member of Congress or employee of Congress owes a duty arising from a relationship of trust and confidence to the Congress, the United States Government, and the citizens of the United States, with respect to material, nonpublic information derived from such person's position as a Member or employee of Congress.

As with any criminal statutes or Executive Branch regulations, the Committee cannot provide binding interpretations of securities law. However, as House Rules and standards have long prohibited related activities, the Committee is available to discuss these matters and assist staff in any appropriate manner.

* * *

As noted above, the Committee will be providing training directed at several of the provisions discussed above, particularly as they relate to financial disclosures. However, any additional questions on any of these matters may be directed to the Committee's Office of Advice and Education at (202) 225-7103.