Conflicts of interest related to new facilities and programs

Cary Williams, Legal Division
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My Work

Over the past few weeks, the Federal Reserve has taken numerous actions to support the economy during the COVID-19 pandemic. These actions include setting up new special purpose lending facilities to handle transactions involving corporate bonds, asset-backed securities, money market mutual funds, and commercial paper.

The new facilities will support the operations of a wider range of companies and entities than those that typically interact with us, and with the new emergency facilities and legislation have come new areas of potential conflicts of interest. Holdings that have not been an issue suddenly can be problematic, including the following:

For more information

- Financial Conflicts of Interest Law
- OGE Overview of Financial Conflicts of Interest
- ItB Ethics Reminder: Conflicts of Interest
- ItB Ethics Reminder: Bank Stocks, Managed Accounts, and Robo-Advisors
- Guidance on Misuse of Nonpublic Information

Money market funds, mutual funds, and ETFs: The conflicts of interest laws prohibit Board employees from working on a Fed assignment that could have a direct and predictable effect on their own financial interests or the financial interests of their spouse or minor child. The rules provide an exemption for matters affecting the **underlying holdings** of **diversified** money market funds, mutual funds, and ETFs. (Sector funds can present other issues.) The rules also exempt interests arising from ownership of shares of the funds themselves provided the employee is participating a **matter of general applicability** such as the establishment of a facility to lend to those funds. However, **the exemption does not apply to matters specifically involving a particular fund.** Thus, an employee who owns shares in a particular fund should not work on a matter specifically affecting that fund.

Examples:

1. Paul owns $100,000 worth of shares in Fidelity Large Cap Stock Fund. One of the top 10 holdings of the fund is Bank of America stock. Paul may work on any Board matter affecting Bank of America.
2. Paul also owns $100,000 worth of shares in Vanguard Total Bond Market ETF. Paul may work on **general matters** related to the Board's Secondary Market Corporate Credit Facility (SMCCF), which will purchase in the secondary market corporate bonds issued by certain U.S. companies and eligible corporate bond portfolios in the form of ETFs. **However, Paul may not participate in a matter specifically affecting the Vanguard Total Bond Market ETF**, such as matters related to a specific purchase by the facility of shares of that fund.

Stocks and bonds: If an employee owns stock or bonds in a company, then any Board matter affecting the company's revenues or earnings is considered to have a "direct and predictable effect" on the employee's financial interest. If an employee holds a bond issued by a company, a matter that could affect the company's ability or willingness to meet that debt obligation has a "direct and predictable effect" on the employee's financial interest. In addition, matters that could affect the marketability or market resale value of a corporate bond (e.g., by affecting the company's credit rating) would have a "direct and predictable effect" on the financial interest of an employee who holds a bond issued by the company.

Similarly, an employee who owns a municipal bond should not work on a matter that would affect the marketability or market resale value of the bond (e.g., by affecting the issuer's credit rating) or the issuer's ability or willingness to repay its debt obligations (e.g., by affecting the issuer's financial stability or, for a revenue bond, by affecting the financial viability of the specific project funding the bond).

Broad policy matters that are directed to the interests of a large and diverse group of persons or entities are not covered by the conflicts of interest law. The types of matters covered encompass only matters that involve deliberation, decision, or action that is focused upon the interests of specific persons or entities, or a discrete and identifiable class of persons or entities. Thus, for example, the Board's decision to establish the Primary Market Corporate Credit Facility (PMCCF) for new bond and loan issuance is not a matter covered by the conflicts of interest law, while the decision to support credit to a discrete industry or to a specific company could be covered. As a result, stock in or bonds issued by entities that the Board does not regulate or typically do business with can present conflicts of interest for Board members and staff.

Examples:

1. Paul owns $20,000 worth of stock in BigTech Company, a computer chip manufacturer. Paul may participate in general matters relating to the Board's Primary Market Corporate Credit Facility, which may provide liquidity to large employers including BigTech. However, he may not participate in a decision to extend credit to BigTech specifically.
2. Paul also owns a Maryland state bond and a Baltimore County municipal bond. Paul may participate in general matters related to facilitating the flow of credit to municipalities by expanding the Money Market Mutual Fund Liquidity to include a wider range of securities. He may not, however, participate in matters specifically affecting the state of Maryland's or Baltimore County's ability to meet their debt obligations, or the marketability or market resale value of the specific bonds.

All Board employees—especially those involved in the Board's new programs and areas of responsibility—should review their own and their spouse's financial holdings, be careful to avoid potential conflicts of interest, and consult with ethics officials, Cary Williams and Sean Croston, if any questions arise.

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Ethics reminder on the misuse of nonpublic information

Cary Williams and Sean Croston, Legal Division
Published: May 6, 2020

My Work

Board employees must strictly preserve the confidentiality of nonpublic government information, and may disclose it only as required for official purposes and only as authorized by the Board.

They may not use nonpublic information to further their own private interests or those of another—whether through advice, recommendation, or knowing, unauthorized disclosure. For example, **employees must not do the following**:

- buy or sell stock or engage in other personal financial transactions on the basis of nonpublic information, or enable others to do so
- disclose nonpublic information to friends, family members, business associates or prospective employers
- share the information on social media or otherwise divulge it without authorization

In addition, employees must follow applicable Board policies related to various categories of nonpublic information including FOMC information, national security information, and personally identifiable information.

What is nonpublic information?
Nonpublic information is information that employees gain by reason of federal employment and that they know or reasonably should know has not been made available to the general public. It includes, but is not limited to, information that is exempt from disclosure under the Freedom of Information Act, information that the Board has designated as confidential, or information that has not actually been released to the general public and is not authorized to be released to the public upon request.

This could include information obtained while, for example:

- working on an emergency lending facility
- working on a bank holding company application or other bank supervisory matter
- drafting a statement of work for a contract or evaluating vendor proposals
- preparing FOMC materials
- conducting a survey of business contacts
- writing a speech or testimony
- preparing a statistical release

Penalties for misuse of nonpublic information
A misuse of nonpublic information could result in disciplinary action including suspension or dismissal from Board employment.

It also could result in prosecution under several laws providing criminal penalties for the wrongful use or disclosure of confidential and inside information. Please see the following examples:

1. In 2016 a former Federal Reserve Bank of New York employee was criminally prosecuted and pled guilty to theft of government property after providing confidential supervisory information to his former NY Fed supervisor who had left to work at Goldman Sachs.

2. In 2019, a former SEC employee was criminally charged with disclosing inside information on ongoing investigations to a firm where he sought employment.

3. In 2019, a former Medicare official was criminally convicted for sharing nonpublic information about agency rulemakings with his friend, a "king of political intelligence," who sold the information to hedge funds.

4. In 2019, a former HUD employee was criminally convicted of disclosing nonpublic information about agency procurements to a business owner, thereby giving him an unfair advantage in competing for contracts.

Questions?
Please email Board ethics officials Cary Williams or Sean Croston if you have any questions regarding nonpublic information or any other ethics matter.

Recent news

Watch the latest Employee Life News
Learn more about Stage 3 of the Return to Office plan, staff lounges in the Martin Building, the latest from Dr. Singleton, and the recent SmartBenefits newsletter
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