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LEGAL ADVISORY

TO: Designated Agency Ethics Officials

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SUBJECT: Sector Fund Exemption Applies to Non-Sector Lines of Business or Subsidiaries of a Company in the Sector

This Legal Advisory clarifies that, pursuant to the sector fund exemption,¹ an employee may participate in a particular matter that affects a non-sector line of business or a subsidiary of a company that operates within the sector that is the focus² of the fund.³ After discussing the plain-language reading of the exemption and the reasoning for it, this Legal Advisory explains why the exemption can be appropriately read to extend to non-sector lines of business and subsidiaries based on the same reasoning. The Legal Advisory concludes by highlighting the most common situation to consider when applying this interpretation, including an illustrative scenario of when it applies and a cautionary scenario of when the exemption cannot be utilized.

I. Language of the Sector Fund Exemption

The primary criminal conflict of interest statute⁴ prohibits employees of the executive branch from participating in an official capacity in a particular matter in which, to the employee's knowledge, the employee (or persons or organizations whose interests are imputed to the employee) has a financial interest. The U.S. Office of Government Ethics (OGE) issued an exemption permitting an employee to participate in a particular matter that affects a holding of a sector fund, provided that the affected holding is not invested in the sector in which the fund concentrates and the disqualifying financial interest arises because of the ownership interest in the fund.⁵ OGE adopted this sector fund exemption because, in such circumstances, the effect on

¹ 5 C.F.R. § 2640.201(b)(1). The exemption applies to both mutual funds and unit investment trusts. *See id.* This Legal Advisory uses the term “sector fund” as shorthand for both.

² Frequently, the focus of the fund is apparent from the name of the fund, for example the ABC Energy Fund. However, the prospectus for the fund provides definitive information indicating the “principal investment strategy” or “fund objective” to help ethics officials and filers determine both whether a fund is a diversified fund or a sector fund and, if a sector fund, in which sector the fund focuses. *See* 5 C.F.R. § 2640.102(a) note; *see also* OGE Inf. Adv. Op. 00x8, at 9-10 (Aug. 25, 2000). This advisory was also issued as OGE DAEOgram DO-00-030 (Aug. 25, 2000).

³ For example, an executive branch employee of the Federal Energy Regulatory Commission who owns a financial sector fund may participate in a particular matter that only affects a natural gas subsidiary of a financial services company that is a holding of the financial sector fund.

⁴ 18 U.S.C. § 208(a).

⁵ 5 C.F.R. § 2640.201(b)(1).



the employee's financial interest is too remote or inconsequential to affect the integrity of the employee's federal service. In the regulation, OGE provided an example of circumstances when the exemption could be utilized—an employee of a banking regulator who owns a utility fund that holds stock in a regional bank may participate in a particular matter that has a direct and predictable effect on that employee's financial interest in the regional bank because the bank is not in the utility sector in which the fund concentrates.⁶

II. Clarification of the Interpretation of the Sector Fund Exemption

This Legal Advisory clarifies that an employee also may participate in a particular matter, pursuant to the exemption at 5 C.F.R. § 2640.201(b)(1), affecting a sector holding of the fund if the particular matter affects only a non-sector line of business or subsidiary of that holding. This is so because an employee's disqualifying financial interest arises from ownership in the sector fund and the affected financial interest is not in the sector in which the fund concentrates. As discussed above, OGE adopted the sector fund exemption because, in such circumstances, the effect on the employee's financial interest is too remote or inconsequential to affect the integrity of the employee's service. The same rationale applies when an employee is participating in a particular matter that affects a line of business or a subsidiary of a company that is not the focus of the sector in which the fund concentrates. Accordingly, the exemption permits an employee to participate in a particular matter affecting a company that is a holding of a sector fund, provided that the line of business or subsidiary affected by the particular matter is not in the sector in which the fund concentrates.

Consistent with this clarification, the banking regulator from the example discussed above who owns a utility fund also may participate in a matter that only affects a banking subsidiary of an utility company that is a holding of the utility fund. The potential conflict of interest for the banking regulator created by the employee's indirect holding of a utility company that operates a bank is analogous to the potential conflict of interest when the banking regulator owns a utility fund that happens to own a bank. In both cases, the focus of the sector is the pivotal factor.

III. Application of the Interpretation of the Sector Fund Exemption

In order to assist with the application of this clarified interpretation, OGE is highlighting below when this analysis is most likely to be utilized and how the exemption applies, followed by a scenario in which the exemption does not apply.

The most common circumstance when this clarified interpretation applies is with conglomerates that operate in a number of industries but have primary business activities that fall within a particular sector.⁷ For instance, consider a scenario regarding an employee of the

⁶ *See id.* ex. 1.

⁷ The Standard & Poor's Financial Services LLC (S&P) and MSCI developed the Global International Classification Standard (GICS) in 1999 to create a complete, consistent set of industry and sector classification. *See* S&P GLOB. MKT. INTEL., GICS® HISTORY (2016), <https://www.spglobal.com/marketintelligence/en/documents/gics-history-brochure.pdf>. Under the GICS, businesses are classified into one of 11 sectors based on their primary business activities. This classification system is often the basis for making a company's stock a holding of a particular sector fund. For example, the following are conglomerates held by sector funds that have lines of business or subsidiaries

Federal Maritime Commission who owns a communications fund. That fund holds stock in the global media company which happens to own a cruise line. The employee may participate in particular matters affecting cruise lines even though the global media company owns a cruise line that is regulated by the Federal Maritime Commission. This is so because the only portion of the global media company's business affected by the particular matter at issue, the cruise line, is not in the sector that is the focus of the fund. Therefore, the exemption applies.

This interpretation, however, would not permit an employee of the Federal Maritime Commission's communications office who owns more than the *de minimis*⁸ amount of a communications fund to use the exemption to participate in a particular matter, such as deciding which network should get an exclusive interview. In that case, the particular matter in which the employee is participating would affect the companies operating in the sector that is the focus of the fund—including the global media company—and the *de minimis* exemption for the sector fund is not available.

If ethics officials have any questions about this Legal Advisory or whether the exemption for non-sector holdings of sector funds at 5 C.F.R. § 2640.201(b)(1) applies in a particular situation, they should contact their OGE Desk Officer.

that do not operate in the sector that is the focus of the sector fund: (1) Alphabet (Google), which is in the communications sector; (2) Berkshire Hathaway, which is in the financial services sector; and (3) Honeywell, which is principally in the aerospace and defense sectors.

⁸ See 5 C.F.R. § 2640.201(b)(2).