

August 1, 1997

SECY-97-174

FOR: The Commissioners

FROM: Karen D. Cyr /s/
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Designated Agency Ethics
Official

SUBJECT: NRC EMPLOYEE OWNERSHIP OF ENERGY OR UTILITY SECTOR
MUTUAL FUNDS

PURPOSE:

To inform the Commission of the effect of the prohibition in the new Office of Government Ethics financial interest exemption regulations on employee participation in certain particular matters affecting entities whose securities are contained in the portfolios of sector mutual funds; and to recommend no changes to the current NRC supplemental conduct regulation on prohibited securities.

BACKGROUND:

The Office of Government Ethics (OGE) issued regulations earlier this year that exempted a number of financial interests from the prohibition in 18 U.S.C. § 208(a). That statutory provision prohibits Federal employees from personal and substantial participation in any particular Government matter that employees know could have a direct and predictable affect on their financial interests or the financial interests of certain others, such as their spouse or minor children. The effect of the regulations, therefore, is to permit employees to work on Government matters in which they hold specified "minor" financial interests.

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For example, these regulations now allow an NRC employee to work on a materials license application, even though the employee owns stock in the license applicant, as long as the value of the employee's stock does not exceed \$5,000. The employee can also participate in general matters affecting the license applicant, such as rulemaking, if the value of the stock holding does not exceed \$25,000. (Employee Announcement No. 19 (March 12, 1997) describes these new regulations in more detail.)

These regulations also permit employees to participate in particular matters affecting the holdings of a mutual fund without regard to the amount of the employee's investment in that fund as long as the fund is "diversified." A mutual fund is "diversified" if it does not have a policy of concentrating its investments in a particular "sector," such as a specific industry, business, foreign country, or State. Therefore, an employee may work on a license application even though the employee has more than a \$5,000 investment in a diversified mutual fund which holds securities issued by that license applicant.

However, if the mutual fund is concentrated in a "sector," such as energy, utilities, or telecommunications, the employee cannot work on any particular matter affecting any entity in that sector whose securities are part of the fund's portfolio if the employee's investment in that fund exceeds \$5,000. For example, an employee who owns \$6,000 in a utility sector fund cannot work on a license amendment for a utility whose stocks are in the fund's portfolio, even though the actual value of the employee's interest in that particular utility is insignificant. Thus, under the OGE regulations, if the portfolio of a utility sector fund has five percent of its total assets invested in fifteen nuclear utilities, the NRC employee could not work on matters affecting any of those fifteen utilities, even though 95 percent of the portfolio was invested in non-nuclear utilities. Ownership of such a fund could impose substantial limitations on the employee's work assignment, unless a waiver is granted permitting the employee to work on matters affecting entities whose securities are held by the fund.

The NRC was concerned about employee ownership of utility sector funds before OGE addressed this issue in these regulations. In 1994, when the NRC republished, with OGE concurrence, its prohibited security regulation, the NRC added a prohibition on owning any sector energy or utility mutual fund on the OGC prohibited securities list which has more than 25 percent of its assets invested in prohibited securities. (On the average, only about a dozen sector utility funds are on the prohibited securities list.) Employees are free to buy or continue to hold any other energy or utility sector fund. Under the rules then in force, employees could work on matters affecting the holdings of sector funds which did not have sufficient nuclear holdings to be placed on the prohibited securities list.

When OGE published these regulations as a proposed rule in 1995, we submitted written comments recommending that sector funds be exempted from the restriction, just like diversified funds. The OGE rejected our proposal. We then proposed, in light of our own

security regulation, that the NRC be allowed to treat energy or utility sector funds whose nuclear assets fall below the 25 percent threshold the same as a diversified mutual fund. The OGE did not agree with this approach.

The March 12, 1997, Employee Announcement on the new OGE regulations cautioned employees who invest in a sector fund of their responsibilities to review the most recent prospectus to ascertain the fund's assets because they may have to disqualify themselves from involvement in a matter affecting the fund's holdings.

DISCUSSION:

We believe that there are two options for the Commission to consider, with respect to employee ownership of sector mutual funds, especially utility or energy sector funds:

1. Amend the prohibited security regulation to extend the bar to all sector utility or energy mutual funds. This would increase the number of prohibited funds to about fifty but would reduce the risk that NRC's professional employees would violate Federal criminal law by participating in matters affecting holdings in these funds. However, this amendment would not deal with the problem of employees with responsibilities in other areas, such as telecommunications or the regulation of medicine, owning a sector mutual fund in either of these areas.
2. Retain the current prohibited security regulation (which covers energy and nuclear utility sector fund portfolios containing more than 25 percent prohibited securities) and place the responsibility on the individual employee for compliance with requirements concerning participation in matters affecting the holdings of non-prohibited sector funds. In addition, the agency will remind all employees through ethics training and announcements of the prohibition on involvement in matters affecting the holdings of sector funds.

RECOMMENDATION:

To date, we know of no allegations of employee violation of the sector mutual fund rule. Moreover, the philosophy behind the ethics regulations issued by the OGE is based on the premise that the primary responsibility for compliance with the ethics laws and regulations rests with the employee. We do not recommend that the Commission enlarge the scope of the prohibited securities list, particularly since some of the energy or utility sector funds might not contain any prohibited securities. To address the issue of employee participation in matters affecting holdings of sector funds, waivers permitting participation will be issued when appropriate.

The Commissioners

-4-

For these reasons, we recommend no change to the current prohibited security regulation. Unless the Commission directs otherwise we will prepare an agency-wide announcement reiterating employee responsibilities in this area.

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