Conflicts of Interests Considerations: Private Investment Funds and Employment with an Investment Fund

(Last updated June 22, 2018)

Topics covered include: Ownership of a Private Investment Fund | Investment Fund Director, Manager, or Employee

This guidance focuses on potential conflicts of interest that can arise from financial interests that are common to ownership of a private investment fund or that often accompany employment with an investment fund. For guidance regarding potential conflicts that can arise from other types of investment vehicles, see Conflicts of Interest Considerations: Legal Entities that Hold Assets.

Please note that this guide is an evolving document that OGE plans to update over time. If you have any questions, please contact your OGE desk officer or your agency ethics official.

This guide does not contain legal advice. It is intended solely for educational and informational purposes for ethics officials in the Federal executive branch.

Ownership of a Private Investment Fund

Employee's Ownership of a Private Investment Fund

18 U.S.C. § 208

Under 18 U.S.C. § 208, an employee is prohibited from participating personally and substantially in any particular matter in which the employee knows they have a financial interest directly and predictably affected by the matter, or in which they know that a person whose interests are imputed to them has a financial interest directly and predictably affected by the matter. If a Federal employee has an equity interest in a private investment fund[1] as an investor, the employee has a financial interest under 18 U.S.C. § 208 in particular matters affecting the fund itself and in particular matters affecting the underlying assets of the fund.

Other than employees of agencies that regulate or investigate investment vehicles, few employees will be able to affect an investment fund as a specific entity or as a category of pooled investment vehicles. The more likely source of conflicts is the fund's underlying assets. When analyzing an investment fund's underlying assets for potential conflicts of interest, first determine whether the employee has the potential to participate personally and substantially in particular matters

[1] Private investment funds include but are not limited to the following types of funds: hedge funds, private equity funds, venture capital funds, or family investment funds.

affecting the assets that the fund holds. If a potential for a conflict of interest exists, the ethics official, in consultation with the employee, can then decide whether recusal, divestiture, or some other remedy is appropriate to resolve the conflict of interest.

In addition to examining the current assets held by a private investment fund, the employee should consider the likelihood of the fund acquiring potentially conflicting assets in the future. One signal that a fund is likely to acquire assets is the employee having an obligation to provide capital in the future, such as by a **capital call.** If the fund is still in the acquisition stage, the employee needs to determine whether there is or can be a limit to the types of assets acquired or whether the employee can monitor the acquisitions to determine if the employee has new recusal obligations. Monitoring the new assets being acquired by the fund and evaluating each new asset for potential conflicts of interest can be extremely difficult. Therefore, OGE encourages employees (and often requires Presidential nominees) to divest private investment funds acquiring new assets if the employee has knowledge of some or all of the holdings of the fund.

> **Caution:** Employees and ethics officials must examine a private investment fund's underlying assets for potential conflicts of interest even if the fund qualifies as an excepted investment fund (EIF).[2] Status as an EIF limits only the information that is reportable on a financial disclosure report but does not limit the applicability of 18 U.S.C. § 208.

Funds Organized as Partnerships or LLCs: 18 U.S.C. § 208 imputes the interests of a general partner to an employee, whether the employee is also a general partner or merely a limited partner. Therefore, if a fund is organized as a partnership, the interests of the fund's general partner will be imputed to the employee. The imputation of a general partner's interests can prove problematic in the case of smaller investment funds consisting of the employee's friends or relatives. At the same time, 18 U.S.C. § 208 does not impute the interests of a managing member of a limited liability company to the other members, so the analysis for partnerships does not apply to LLCs.

Exemptions: The private investment fund itself will not qualify for the regulatory exemptions at 5 C.F.R. § 2640.201(a) and (b) for diversified or sector mutual funds. However, several of the exemptions in 5 C.F.R. Part 2640 address conflicts that may arise from having equity in an investment fund. Ethics officials should consider whether, for example, the diversified employee benefit plan exemption at 5 C.F.R. § 2640.201(c) may be available for a fund held in an employee benefit plan. In addition, if the underlying assets are publicly traded securities, as defined as 5 C.F.R. § 2640.105(p), the exemptions at 5 C.F.R. § 2640.202 for interests in securities may be available. When determining whether a *de minimis* exemption applies, remember (1) to aggregate the value of securities that may be similarly affected by the same particular matter and (2) that the exemption does not apply to non-publicly traded securities. If a fund is organized as a

[2] If an employee is the manager of the fund or controls the investment decisions for the fund, a fund that might qualify as an EIF for an investor will not qualify as an EIF for that employee.

partnership, these exemptions may not resolve the conflict unless the interests of the general partner in the fund are also exempt.[3]

For funds organized as limited partnerships, the exemption at 5 C.F.R. § 2640.202(f)(2) may apply for certain interests of general partners when an employee is a limited partner in a partnership with at least 100 limited partners. Ethics officials are encouraged to contact OGE when applying this exemption because OGE has found it difficult to meet the exemption's criteria in practice.

Additionally, 5 C.F.R. § 2640.202(f)(1) permits an employee to participate in any particular matter when the financial interest arises from a general partner's interest, known to the employee, in publicly traded securities, long-term Federal securities, and municipal securities, provided that (1) the ownership is not related to the partnership between the employee and general partner, and (2) the value of the securities does not exceed $200,000.

Agency-Specific Restrictions

If the employing agency has a prohibited holdings statute or regulation, the employee should consider whether those restrictions apply to the investment fund or its underlying assets. If a prohibited holdings statute or regulation applies, then the exemptions in 5 C.F.R. Part 2640 will not be available for that asset.[4]

Spouse's or Minor Child's Ownership of a Private Investment Fund

18 U.S.C. § 208

Because the financial interests of an employee's spouse or minor children are imputed to the employee, a private investment fund that is owned by a spouse or minor child is analyzed under 18 U.S.C. § 208 as if the employee owns it. Note, however, that 18 U.S.C. § 208 imputes only the interests of the *employee's* general partner to the employee, so the analysis for general partners does not need to be conducted if it is the employee's spouse or minor child who has the investment interest in a partnership.

Investment Fund Director, Manager, or Employee

Employee's Position with a Private Investment Fund

18 U.S.C. 208

Imputed Interests under 18 U.S.C. § 208: 18 U.S.C. § 208 imputes to the Federal employee the financial interests of any organization in which the employee serves as officer, director, trustee, general partner, or employee. Therefore, a Federal employee who is a director, manager, or employee of a private investment fund is prohibited by 18 U.S.C. § 208 from participating personally and substantially in a particular matter that the employee knows will have a direct and

[3] *See* 5 C.F.R. § 2640.202(f).
[4] *Id.* § 2640.204.

predictable effect on the financial interests of the investment fund, including the underlying holdings of the fund. This is true regardless of whether the employee has an ownership interest in the fund.

Equity and Economic Interests in an Investment Fund under 18 U.S.C. § 208: Directors, managers, and employees of, and advisors to, private investment funds often have an equity interest in the fund itself as an investor. That equity interest should be analyzed in the same manner as any other investor's equity interest in the fund, which is discussed above under "Ownership of a Private Investment Fund." The employee may also have a **carried interest** (share of the profits) in the fund, which is an economic interest in the fund. The carried interest in the fund is treated the same as an equity interest in the fund for purposes of analyzing any conflict of interest under 18 U.S.C. § 208.

Exemptions: Because a carried interest is not an ownership interest, the carried interest itself will not qualify for any of the regulatory exemptions at 5 C.F.R. Part 2640. As discussed above, several of the exemptions in 5 C.F.R. Part 2640 address conflicts that may arise from having equity in an investment fund.

5 C.F.R. § 2635.502 (Impartiality)

Under 5 C.F.R. § 2635.502, an employee who was formerly an investment fund director, manager, or employee will have a "covered relationship" with their former employer for a period of one year after the termination of the employment.[5] An employee will also have a "covered relationship" with an organization in which the employee is an active participant,[6] or has or seeks a business, contractual, or other financial relationship that involves other than a routine consumer transaction.[7] Therefore, until the covered relationship has terminated, (1) when an employee knows that a person with whom they have a covered relationship is or represents a party to a particular matter, and (2) when the employee determines that the circumstances would cause a reasonable person with knowledge of the relevant facts to question their impartiality in the matter, the employee should not participate in the matter without informing the agency designee and receiving authorization.[8] Even if 18 U.S.C. § 208 does not prohibit the employee's participation in a particular matter, such as when an employee no longer holds a position, or if the employee holds a position other than those identified in the statute and does not have any equity in the fund, the restrictions in 5 C.F.R. § 2635.502 will nevertheless apply.

Outside Earned Income Restrictions

Presidential appointees to full-time noncareer positions are subject to the ban on receiving any outside earned income for activities performed during Government service.[9] Covered noncareer employees, as defined by 5 C.F.R. § 2636.303(a), are subject to a ban on receiving, in a calendar

[5] *Id.* § 2635.502(b)(1)(iv).
[6] *Id.* § 2635.502(b)(1)(v).
[7] *Id.* § 2635.502(b)(1)(i).
[8] *Id.* § 2635.502(a).
[9] *See* Exec. Order No. 12,674, § 102; 5 C.F.R. § 2635.804(a).

year, outside earned income – including honoraria – that exceeds 15% of the annual rate of basic pay for level II of the Executive Schedule ($28,050 for calendar year 2018).[10]

Other Restrictions for Covered Noncareer Employees

If a covered noncareer employee intends to continue to have a role managing the fund while in Government service, the employee and their ethics official should consider the limitations on outside employment found in 5 U.S.C. app. § 502 and 5 C.F.R. Part 2636, Subpart C. First, these provisions bar a covered noncareer employee from receiving compensation for serving as an officer or member of the board of any association, corporation, or any other entity.[11] Second, these provisions bar a covered noncareer employee from receiving compensation for affiliating with or being employed by an entity that provides professional services involving a fiduciary relationship, which includes fund management.[12] Third, these provisions bar a covered noncareer employee from permitting the use of their name by any firm, partnership, association, corporation, or other entity which provides professional services involving a fiduciary relationship.[13]

Agency-Specific Restrictions

Some agencies have prohibited holdings statutes or regulations that restrict ownership of certain assets. If a prohibited holdings statute or regulation applies, then the exemptions in 5 C.F.R. Part 2640 will not be available for that asset.[14]

[10] *See* 5 U.S.C. app. § 501(a)(1); 5 C.F.R. § 2635.804(b); OGE Legal Advisory LA-18-01 (2018).
[11] 5 U.S.C. app. § 502(a)(4); 5 C.F.R. § 2636.306.
[12] 5 U.S.C. app. § 502(a)(1); 5 C.F.R. § 2636.305(a)(1)(ii).
[13] 5 U.S.C. app. § 502(a)(2); 5 C.F.R. § 2636.305(a)(2).
[14] 5 C.F.R. § 2640.204.