

[Securities Regulation Daily Wrap Up, TOP STORY—Congressional update: House Judiciary Committee mulls court ethics while House passes bills on financial transparency and vulnerable adults, \(Oct. 26, 2021\)](#)

Securities Regulation Daily Wrap Up

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By [Mark S. Nelson, J.D.](#)

Legislation to be introduced in the House and Senate would impose STOCK Act-like disclosures on members of the federal judiciary who engage in securities transactions that may imperil their impartiality to hear cases.

The House Judiciary Committee's Subcommittee on Courts, Intellectual Property, and the Internet heard from a range of witnesses about the need to for Congress to impose ethical rules on federal judges following a report in *The Wall Street Journal* that identified numerous federal judges who had failed to recuse themselves from cases they heard in which they had a financial interest in at least one of the parties appearing before them. Meanwhile, the House passed bills that would protect seniors and other vulnerable adults from financial exploitation and would require federal financial regulators to make information filed with or furnished to them available in searchable, machine-readable formats.

Securities transactions and federal judges. The House Judiciary Committee's Subcommittee on Courts, Intellectual Property, and the Internet held a hearing regarding the limits of current laws and rules applicable to judicial ethics and transparency. Subcommittee Chair Henry C. "Hank" Johnson (D-Ga) opened the hearing by noting that federal judges currently make financial disclosures only once per year and are responsible for recusing themselves from hearing cases when they have conflicts of interest; he also noted that the U.S. Supreme Court currently has no code of ethics. Chair Johnson said he would reintroduce the Courthouse Ethics and Transparency Act, a version of which was recently introduced by a group of senators.

Representative Jerrold Nadler (D-NY), chair of the full House Judiciary Committee, [said](#) he hoped the article that appeared in *The Wall Street Journal* would spur reconsideration of current judicial ethics standards. He also noted that, in response to that article, some judges acknowledged problems while others blamed their clerks or conflict checking software for failures to recuse. "The federal judiciary is a pillar of our nation's government; an institution nearly synonymous with upholding the rule of law," said Chair Nadler. "When Congress, as a co-equal branch, conducts oversight of the courts with hearings such as this one, it is with the following goal in mind: to promote and protect this vital institution in order to safeguard judicial independence and maintain public confidence in our courts."

Subcommittee Ranking Member Darrell Issa (R-Calif) said in a [press release](#): "No part of our foundation of law and order can proceed without the considered, continuous and constant work of judges – and that's why an unbiased judiciary is imperative. Under this act, we will equalize the accountability of our third branch of government to the same standard of elected officials."

The [House](#) and [Senate](#) versions of the Courthouse Ethics and Transparency Act of 2021, would mandate transaction reporting by federal judges under the Ethics in Government Act. Specifically, reports would have to be filed consistent with the terms of Section 102(a)(5) of the Ethics in Government Act, which requires a subject individual to provide a brief description and other information about transactions during the preceding calendar year that exceeded \$1,000 in real property (excepting a personal residence) and in stocks, bonds, commodity futures, and other securities.

A statement of findings section within the proposed bill indirectly mentions the article in *The Wall Street Journal* on recusals by federal judges, while also noting that current law requires recusal when a federal judge has a financial interest in the subject matter or a party to federal court proceedings. The findings also reiterate that the

STOCK Act extended insider trading provisions of the federal securities laws to members of Congress and other federal officials.

Reports made by federal judges would be made available to the public via a searchable Internet database, with some exceptions for personal and sensitive information that, if published, could endanger that person or his or her family. The bills refer to existing law that provides for redaction only to the extent necessary to protect the reporting individual or that persons' family while the danger exists. The Judicial Conference, in consultation with United States Marshals Service, must make a finding of the need for not requiring the immediate and unconditional availability of reports. In recent years, federal judges and their families have been targeted by violent persons in at least two instances, one involving the family of Judge Joan Humphrey Lefkow of the U.S. District Court for the Northern District of Illinois and, more recently, the family of Judge Ester Sales of the U.S. District Court for New Jersey.

In addition to Subcommittee Chair Johnson, the House bill is [supported](#) by Reps. Deborah Ross (D-NC), Darrell Issa (R-Calif), and Chip Roy (R-Texas). The Senate bill likewise has bipartisan support from a politically diverse group, including Sen. John Cornyn (R-Texas), the bill's sponsor, and fellow Republican Sens. John Kennedy (R-La), Chuck Grassley (R-Iowa), Ted Cruz (R-Texas), and Democratic Sens. Chris Coons (D-Del), Sheldon Whitehouse (D-RI), Dick Durbin (D-Ill), and Jon Ossoff (D-Ga).

Practical and constitutional issues. Renee Knake Jefferson, Doherty Chair in Legal Ethics & Professor of Law University of Houston Law Center, [testified](#) that the issues identified by the article in *The Wall Street Journal* have elements of intimidation that also were present when several federal judges were accused of sex harassment a few years ago. She urged lawmakers to facilitate a cultural change from one of "silence" to one of "compliance."

According to Dylan Hedtler-Gaudette, Government Affairs Manager, Project On Government Oversight, a non-partisan, independent watchdog group, [said](#) that the federal judiciary has no greater power than its impartiality but that judges who act without being impartial can undermine the rule of law. He also suggested that problems with conflicts of interest continue to arise for federal judges because the judicial branch is the least accountable branch of the federal government. He recommended that, among other things, federal judges be subjected to reporting requirements for their securities transactions and that these disclosures be posted online.

Thomas D. Morgan, Oppenheim Professor of Law Emeritus, The George Washington University Law School, [told](#) the subcommittee that he had "some more positive news" in that the solution to the problem identified by the article in *The Wall Street Journal* could be achieved in a non-controversial and cost efficient manner. He further explained that the solution must focus on the fact that the federal judiciary has a problem. But he also said that conflict checking software used by attorneys in private practice could be part of the solution and that court clerks should do the initial conflict check, followed by a final (and ongoing) evaluation by the individual judge of his or her ability to hear a particular case.

Jamal Greene, Dwight Professor of Law, Columbia Law School, [testified](#) about the prospect of Congress imposing an ethics code on the U.S. Supreme Court. Greene said that neither the Constitution's text nor judicial precedent state a clear answer to whether such Congressional action would be constitutional. Greene, however, suggested that while Congress may have authority to impose an ethics regime on the justices pursuant to its power to make all laws necessary and proper, the justices may have certain authority over enforcing those rules against other justices. Because justices remain on the court during good behavior, they are removable only via impeachment.

Judicial testimony. Lastly, the Hon. Jennifer Walker Elrod of the U.S. Court of Appeals for the Fifth Circuit and Chair of the Committee on Codes of Conduct Of the Judicial Conference of the United States, [testified](#) about current judicial ethics standards. Subcommittee Ranking Member Issa asked Judge Elrod about how to obtain uniform and complete compliance with ethics rules from judges. Judge Elrod replied that judicial disclosures about financial matters and recusals are handled by two different oversight bodies. The judge further explained that some judges have demonstrated a lack of knowledge, for example, between separately managed accounts (controlled accounts) and mutual funds, which typically are accorded a safe harbor for disclosure purposes.

Subcommittee Chair Johnson then inquired about judges who told *The Wall Street Journal* that conflict checking software was to blame for their failures to recuse. Judge Elrod said judges are responsible for being knowledgeable about their own and their family's financial holdings. In reply to a follow-up question about compliance, the judge said that the relevant oversight body makes sure that judges know their obligations and to seek to avoid gaps in software applications. Judge Elrod also said that discipline for noncompliance with judicial policies does exist in the form of action by the Judicial Council and the chief judge in the judge's district. But the judge demurred when asked for a list of judges who have been disciplined because that information is subject to confidentiality, although she said she would inquire about providing the requested information.

In another follow-up question from Subcommittee Chair Johnson about judges who have been proactive in posting their financial disclosures online, Judge Elrod said that requiring this of all judges with respect to recusals might address financial issues but would not address other reasons for recusals, such as personal relationships and potential animosity between the judge and other participants in a case. Judge Elrod also noted concerns that additional disclosures about recusals could harm the privacy interests of third persons and may also lead to forum shopping.

House Judiciary Committee Chair Nadler asked the judge whether requiring all federal judges to hold their financial funds in mutual funds or index funds would solve the problem of financial disclosures, a question he had asked several other witnesses. Judge Elrod agreed that such an approach could simplify the process for judges. She also reiterated that mutual funds typically fall within a safe harbor. But Judge Elrod further reiterated that such an approach may not solve all recusal issues. For example, the judge suggested that other types of financial interests might not be covered. Judge Elrod then noted that she keeps her funds in mutual funds because that makes the funds easier to handle as a judge.

Vulnerable adults. The House passed the Financial Exploitation Prevention Act of 2021 ([H.R. 2265](#)), sponsored by Rep. Ann Wagner (R-Mo). The bill provides that a registered open-end investment company or that company's transfer agent may generally postpone payment of the redemption of securities for more than seven days if the company or the transfer agent reasonably believes the redemption request was the product of the financial exploitation of a vulnerable adult. The postponement may be for a total of up to 15 business days but can be lengthened by 10 more business days if an internal review by the company or transfer agent determines that the redemption was requested through the financial exploitation of a vulnerable adult. The bill also provides that a state regulator or a court can extend the seven-day period.

The technical term used by the bill for a vulnerable adult, "specified adult," would be defined to mean a person who is 65 years of age or older, or a person age 18 years or older, who the company or transfer agent reasonably believes is mentally or physically impaired and cannot protect his or her own interest.

The bill also would require the SEC to make recommendations to Congress to further protect the financial interests of vulnerable adults. The SEC would have to consult with other federal and state financial regulators, including the CFTC, CFPB, FINRA, NASAA, the Fed, the OCC, and the FDIC.

The bill passed the House by a voice vote.

Financial transparency. The Financial Transparency Act of 2021 ([H.R. 2989](#)), sponsored by Carolyn Maloney (D-NY), would require that information reported to federal financial regulators be made electronically searchable with the assistance of RegTech and artificial intelligence tools. Specifically, the bill would add a new provision to the Dodd-Frank Act that would require the Treasury Department to issue data standards in consultation with member agencies, which consist of the voting members of the Financial Stability Oversight Council (FSOC), except that the bill would exclude the CFTC from such list of member agencies.

Title II of the bill would apply to the SEC. Here, the legislation would require the SEC to adopt data standards that incorporate searchability along with schemas documented in machine-readable taxonomies or ontologies that define the semantic meaning of the data. These requirements would apply similarly to many types of disclosure, including: (1) Securities Act disclosures regarding asset-backed securities and corporate disclosures; (2) Exchange Act disclosures regarding nationally recognized statistical rating organizations (NRSROs), proxies,

and security-based swaps reporting; (3) the Investment Company Act and Investment Advisers Act; (4) the Municipal Securities Rulemaking Board (if the Board establishes information systems under Exchange Act Section 15B(b)(3)); and (5) national securities associations, which must adopt standards for information that is regularly filed with or submitted to an association.

The bill passed the House by a vote of [400-19](#).

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