

April 2013

POLITICAL
INTELLIGENCE

Financial Market
Value of Government
Information Hinges on
Materiality and Timing



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Why GAO Did This Study

Companies and individuals use political intelligence to understand the potential effects of legislative and executive branch actions on business, finance, and other decisions. The STOCK Act of 2012 directed GAO to report to Congress on the role of political intelligence in the financial markets. GAO reviewed (1) the legal and ethical issues, if any, that may apply to the sale of political intelligence; (2) what is known about the sale of public and nonpublic political intelligence, the extent to which investors rely on such information, and the effect the sale of political intelligence may have on the financial markets; and (3) any potential benefits and any practical or legal issues that may be raised from imposing disclosure requirements on those who engage in these activities.

To answer these objectives GAO examined federal guidance including Securities and Exchange Commission Rule 10b-5 (related to insider trading), federal disclosure models including the Lobbying Disclosure Act, the Investment Advisers Act, and the Federal Election Campaign Act; and the extent to which data existed to measure the size of the political intelligence industry. GAO also interviewed individuals at political intelligence, media, financial services, and law firms; trade associations; advocacy organizations; and executive and legislative branch officials. Interviewees were selected based on research on the political intelligence industry, their experience with these activities and referrals.

What GAO Recommends

GAO is not making recommendations in this report.

View [GAO-13-389](#). For more information, contact Michelle Sager at (202) 512-6806 or sagem@gao.gov.

POLITICAL INTELLIGENCE

Financial Market Value of Government Information Hinges on Materiality and Timing

What GAO Found

The Stop Trading on Congressional Knowledge (STOCK) Act of 2012 specifically defines political intelligence as information that is “derived by a person from direct communications with an executive branch employee, a Member of Congress, or an employee of Congress; and provided in exchange for financial compensation to a client who intends, and who is known to intend, to use the information to inform investment decisions.” While no other laws or ethics rules specifically govern political intelligence activities, securities laws and executive and legislative branch ethics rules and guidance do provide guidelines for government officials to protect material nonpublic information (e.g., information that has not been disseminated to the general public or is not authorized to be made public). For example, insider trading laws apply to both the executive and legislative branches and prohibit the disclosure of material nonpublic information derived from employees’ official positions for personal benefit.

The prevalence of the sale of political intelligence is not known and therefore difficult to quantify. The extent to which investment decisions are based on a single piece of political intelligence would be extremely difficult to measure. This is in part because a firm’s information is often bundled with other information such as industry research and policy analysis, and because the flow of information does not readily lend itself to quantification or ongoing documentation for the purpose of measuring industry activity. Investors typically use multiple sources of information to influence their investment and business decisions.

Even when a connection can be established between discrete pieces of government information and investment decisions, it is not always clear whether such information could be definitively categorized as material (would a reasonable investor find the information important in making an investment decision) and whether such information stemmed from public or nonpublic sources at the time of the information exchange (information has a higher value at a time when it is not widely known and thus has the potential to inform a profitable transaction). It is also difficult to determine the extent to which nonpublic government information is being sold as political intelligence. Specifically, it is not always possible to determine the timing of when nonpublic information becomes public. Representatives of most political intelligence firms interviewed said they have policies in place to ensure they do not knowingly sell material nonpublic information and potentially violate insider trading laws.

Finally, if Congress chose to supplement existing guidance and laws with required disclosure of political intelligence information, the benefits (such as greater transparency) and costs (such as resources to administer) of disclosure would have to be balanced along with consideration of related practical and legal issues. For example, Congress would need to address the lack of consensus on the meaning of the terms “direct communication” and “investment decision” to provide clarity regarding the definition of political intelligence as well as guidance to specify the purpose of disclosure, who would be required to file, how often disclosures would be required, and who would manage the disclosure process.

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Abbreviations

FDA	Food and Drug Administration
LDA	Lobbying Disclosure Act
OGE	Office of Government Ethics
SEC	Securities and Exchange Commission
STOCK Act	Stop Trading on Congressional Knowledge Act of 2012

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United States Government Accountability Office
Washington, DC 20548

April 4, 2013

Congressional Committees

Companies and individuals use what has been called “political intelligence” to understand the potential impact of legislative and executive branch actions on business, finance, and other decisions. The financial market value of government information hinges on materiality (i.e., would a reasonable investor find the information important in making an investment decision) and timing (i.e., information has a higher value at a time when it is not widely known and thus has the potential to inform a profitable transaction). The Stop Trading on Congressional Knowledge (STOCK) Act of 2012,¹ defines political intelligence as information that is “derived by a person from direct communication with an executive branch employee, a Member of Congress, or an employee of Congress; and provided in exchange for financial compensation to a client who intends, and who is known to intend, to use the information to inform investment decisions.”

The STOCK Act directed GAO to study the role of political intelligence in the financial markets. To meet this mandate, the objectives of this report are to describe (1) the legal and ethical issues, if any, that may apply to the sale of political intelligence; (2) what is known about the sale of public and nonpublic political intelligence information, the extent to which investors rely on such information, and the effect the sale of political intelligence may have on the financial markets;² and (3) any potential benefits and any practical or legal issues that may be raised from imposing disclosure requirements on those who engage in these activities.

To answer these objectives, we examined existing federal guidance on the disclosure of nonpublic information and securities laws (related to insider trading). We also reviewed several federal disclosure models to determine the types of requirements that would likely need to be

¹Pub. L. No. 112-105, 126 Stat. 291 (April 4, 2012).

² Generally, public information is information that has been disseminated to the general public, and nonpublic information is information that has not been disseminated to the general public or is not authorized to be made public.

considered for any potential disclosure model developed for political intelligence. We selected three laws that require the filing of disclosure reports: the Lobbying Disclosure Act (LDA), the Investment Advisers Act, and the Federal Election Campaign Act. These models were selected based on a database search of other disclosure models to ensure their potential applicability, as well as suggestions from external parties such as congressional staff and officials at regulatory agencies. To seek economic data on the size of the political intelligence industry, we searched for political intelligence in the industry classification systems used by federal statistical agencies to collect economic data on U.S. business establishments, the North American Industry Classification System and the Standard Industrial Classification system.

We conducted 34 semi-structured interviews with entities including political intelligence firms, law firms that conduct political intelligence, legal experts who specialize in the LDA, securities law or ethics laws; a media organization; trade associations representing both pension funds and businesses; a financial services firm; non-governmental citizen advocacy or protection organizations that cover public policy issues such as government transparency and openness; an academic researcher specializing in law reform efforts focused on securities fraud; and regulatory bodies including the SEC, Commodity Futures Trading Commission, and Financial Industry Regulatory Authority. We selected these entities and individuals based on database searches using key terms related to political intelligence and referrals from firms we interviewed. The semi-structured interviews with these firms and individuals included questions about the nature of the services they provide; their processes for gathering and disseminating information; the types of clients they represent; their understanding of terms such as lobbying, political intelligence, and policy research; legal and ethical issues related to potential political intelligence disclosure requirements; existing statutes and regulations that cover political intelligence activities; and potential benefits and practical issues that could be raised by imposing disclosure requirements on those who engage in political intelligence activities.

In addition, we conducted interviews about political intelligence with three individuals with broad public policy experience, two of whom were former government officials. We also met with staff from the Senate and House Committees on Ethics to discuss the laws and ethics rules for protecting

government information and corresponded with the Office of Government Ethics. We consulted with the Congressional Research Service and the National Academy of Public Administration as we conducted our work.³

We identified two illustrative examples of the use of government information linked to investment decisions. We used these examples, one involving actions in the legislative branch and another in the executive branch, to frame discussions with executive and legislative branch staff regarding the guidance, policies and procedures in place for protecting and disseminating information that could be defined as political intelligence. In the first example, a longtime congressional debate about legislation regarding the Asbestos Trust Fund litigation led to an instance in 2005 where investors profited prior to an asbestos liability speech on the floor of the Senate.⁴ In the second example a Food and Drug Administration (FDA) chemist used material nonpublic information to make stock trades (i.e., insider trading).⁵ We selected these two examples based on referrals from external parties interviewed for this report, a database search of political intelligence cases with the potential to illustrate the protection and dissemination of government information, and individuals with expertise in matters related to these issues. For these cases we reviewed relevant legal documentation and executive and legislative branch guidance on protecting information. In addition, we interviewed executive branch officials from the FDA and a congressional staff member about current policies and procedures in place for protecting government information.

We conducted this performance audit from April 2012 to April 2013 in accordance with generally accepted government auditing standards.

³For additional information see Congressional Research Service, *The STOCK Act, Insider Trading, and Public Financial Reporting by Federal Officials* (Washington, D.C.: Revised December 2012); *The STOCK Act, Insider Trading, and Public Financial Reporting by Federal Officials* (Washington, D.C.: April 2012); and National Academy of Public Administration, *The STOCK Act: An Independent Review of the Impact of Providing Personally Identifiable Financial Information Online* (Washington D.C.: Mar. 2013).

⁴There are no published reports finding wrongdoing by any of the parties in the 2005 Asbestos Trust Fund litigation case.

⁵The FDA chemist pled guilty to insider trading and making false statements and was sentenced to serve five years in prison and ordered to repay the \$3.7 million in profits gained and losses avoided while using confidential government information to make stock trades.

Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. For more details on our methodology, see appendix I.

Background

The STOCK Act includes several provisions affecting executive and legislative branch employees. For example, the Act makes clear that executive branch employees, Members of Congress, and employees of Congress are not exempt from insider trading prohibitions under securities laws. In addition, the STOCK Act requires that certain financial disclosure forms be made available to the public via official websites,⁶ and that some financial transactions that exceed \$1,000 be filed within 30 to 45 days for certain executive and legislative branch employees, as well as Members and employees of Congress.⁷

Generally, government information can be characterized as public or nonpublic and material or nonmaterial. The definition of political intelligence in the STOCK Act includes public or nonpublic and material or nonmaterial information. Political intelligence information can be collected through briefings, meetings, committee hearings, public or non-public documents, personal conversations, and other communications between an employee of a political intelligence firm and an executive branch employee, a Member of Congress, or a legislative branch employee. The following examples describe two instances where individuals used government information to make investment decisions. These examples

⁶Under existing law, the Internet publication of certain financial disclosure forms will be made available to the public on April 15, 2013.

⁷ Section 6 of the STOCK Act amends Section 103 of the Ethics in Government Act of 1978 (5 U.S.C. app. 103) by requiring that executive and legislative branch employees who file public financial disclosure reports also promptly report any purchase, sale, or exchange of any stock, bond, commodities future, or other covered security that exceeds \$1,000. Section 8 of the STOCK Act requires the Secretary of the Senate and the Clerk of the House of Representatives to ensure that financial disclosure forms filed by Members of Congress, candidates for Congress, and employees of Congress pursuant to title I of the Ethics in Government Act of 1978 are made available to the public on the respective official websites of the Senate and the House of Representatives not later than 30 days after such forms are filed.

provide context for understanding the potential use of political intelligence.

Figure 1: FDA Employee Uses Material Nonpublic Government Information for Personal Gain

In 2011, an SEC enforcement action alleged that a former FDA chemist made \$3.7 million in illegal profits and losses avoided by using nonpublic government information for personal gain. The employee worked for an office that evaluates applications to sell new drugs and had access to highly confidential information. According to the SEC's complaint the FDA employee had conducted unlawful insider trading in advance of at least 28 different announcements concerning FDA decisions on drug applications. Using material, nonpublic information, the chemist purchased stock for a profit; short sold^a stock for a profit; and sold stock to avoid losses. The FDA chemist pled guilty to insider trading in a parallel criminal action.

Source: Amended Complaint for Plaintiff, SEC v. Cheng Yi Liang (Civil No. 8:11-cv-00819-RWT) (filed 6/03/11); Criminal Complaint, U.S. v. Liang (Case No. 11-1236WC) (filed 3/29/11); Judgment in a Criminal Case (Case No. DKC-8-11-CR-00530-001) (filed 3/05/12).

^a A "short sale" is the sale of a security that the seller does not own or any sale that is consummated by the delivery of a security borrowed by, or for the account of, the seller. In general, short selling is used to profit from an expected downward price movement, provide liquidity in response to unanticipated demand, or hedge the risk of a long position (i.e., ownership) in the same or related security.

Figure 2: Investors Make Purchases in Companies Related to the Asbestos Trust Fund Prior to a Public Senate Announcement

A 2005 incident illustrates one way investors may have used government information. In November 2005 the Senate Majority Leader announced that the Senate would vote on a bill to create a trust fund to compensate asbestos victims (S.852, Fairness in Asbestos Injury Resolution Act of 2005), which would have reduced expensive asbestos-related liabilities for a small group of companies. The day before the announcement, day traders noticed increases in the volume of trading in these companies' stocks. Press sources speculated that investors were likely using nonpublic information from congressional staff to make stock purchases, believing the stocks would gain value after the announcement. Ultimately, no enforcement action was taken by the SEC, and the Senate did not pass the bill.

Source: Eamon Javers, "Washington Whispers to Wall Street," BUSINESSWEEK, Dec. 25, 2005 and Brody Mullins and Kara Scannell, "Hedge Funds Hire Lobbyists to Gather Tips in Washington," Wall Street Journal, Dec. 8, 2006.

No Laws or Ethics Rules Specifically Govern Political Intelligence Activities, But Existing Laws and Ethics Rules Apply to the Misuse of Nonpublic Information

There are no laws or ethics rules that specifically govern the sale of information by a political intelligence firm. However, as illustrated in figure 3 and the discussion that follows, there are laws and ethics rules that may govern the purchase and sale of material nonpublic information in the executive and legislative branches, and ethics rules that govern nonpublic information in the executive and legislative branches of government.

Figure 3: Types of Government Information that Could Be Considered Political Intelligence

Information type	Public information	Nonpublic information
Material information Information that is useful in making an investment decision.	Generally no restrictions on this information.	Executive and legislative branch ethics rules, insider trading laws, as well as other laws may govern this information.
Nonmaterial information Information that is not useful in making an investment decision.	Generally no restrictions on this information.	Executive and legislative branch ethics rules as well as other laws (e.g., tax laws and other laws that are specific to federal programs) may govern this information.

Source: GAO analysis of executive and legislative branch ethics guidance, insider trading laws, and other applicable laws that govern the use of information.

Executive branch employees, Members of Congress, and their employees and staff are subject to ethics rules and insider trading prohibitions. The STOCK Act affirmed that executive branch employees, Members of Congress and their employees are not exempt from insider trading prohibitions and that a duty of trust and confidence is owed to the Congress, the government, and the citizens of the United States. Insider trading prohibitions stem from Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5, as well as a long line of judicial

decisions.⁸ SEC investigates cases of insider trading by examining the existence and nature of the duty being breached and both the materiality and nonpublic nature of the information. If material nonpublic governmental information is improperly disclosed to a political intelligence professional in breach of a duty, and that professional sells the information to an investor who trades based on the information, then the government employee or Member of Congress, the political intelligence professional, and the investor could all be liable for potential insider trading violations. According to SEC officials, any party may defend against a claim of insider trading by arguing that the information lacked materiality, the information was public, there was no breach of duty, or there was no act of bad faith. With regard to the legislative branch, attorneys we interviewed for this report explained that Members of Congress may also be able to assert the Speech or Debate privilege of the U.S. Constitution as a defense to any potential charge of insider trading. Such a defense would be based on the principle that the information being shared constituted a legislative act—an integral part of the deliberative and communicative processes by which Members participate in legislative activities. To date, according to the SEC, no Members of Congress have been prosecuted for insider trading based on material nonpublic information learned in the course of their work in Congress under Section 10(b) or Rule 10b-5.

Guidance issued by the House of Representatives Committee on Ethics defines material nonpublic information as any information concerning a company, security, industry or economic sector, or real or personal property that is not available to the general public and which an investor would likely consider important in making an investment decision and is not widely disseminated to the public. Senate ethics rules also define nonpublic information as confidential or not widely disseminated to the public. Both the House and the Senate ethics committees may impose penalties other than ones allowed under securities laws.

Executive branch employees are prohibited from using or allowing the use of nonpublic government information to further their own private

⁸ Section 753 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) amended the Commodity Exchange Act to prohibit manipulation and fraud in connection with any swap, or a contract of sale of any commodity in interstate commerce. The Commodity Futures Trading Commission has promulgated a rule under Section 753 that is modeled on the SEC's Rule 10b-5 and aimed at conduct akin to insider trading.

interests or the private interests of others, and can be subject to penalties for doing so. The Office of Government Ethics (OGE) defines nonpublic information as information that the employee gains by reason of federal employment and that he or she knows or reasonably should know has not been made available to the general public. According to OGE, nonpublic government information includes, but is not limited to:

- information that is exempt from disclosure under the Freedom of Information Act,
- information that the agency has designated as confidential, or
- information that has not actually been disseminated to the general public and is not authorized to be made available to the public upon request.

The Prevalence of the Sale of Political Intelligence Is Unknown, but Some Investors Use It to Inform Investment Decisions

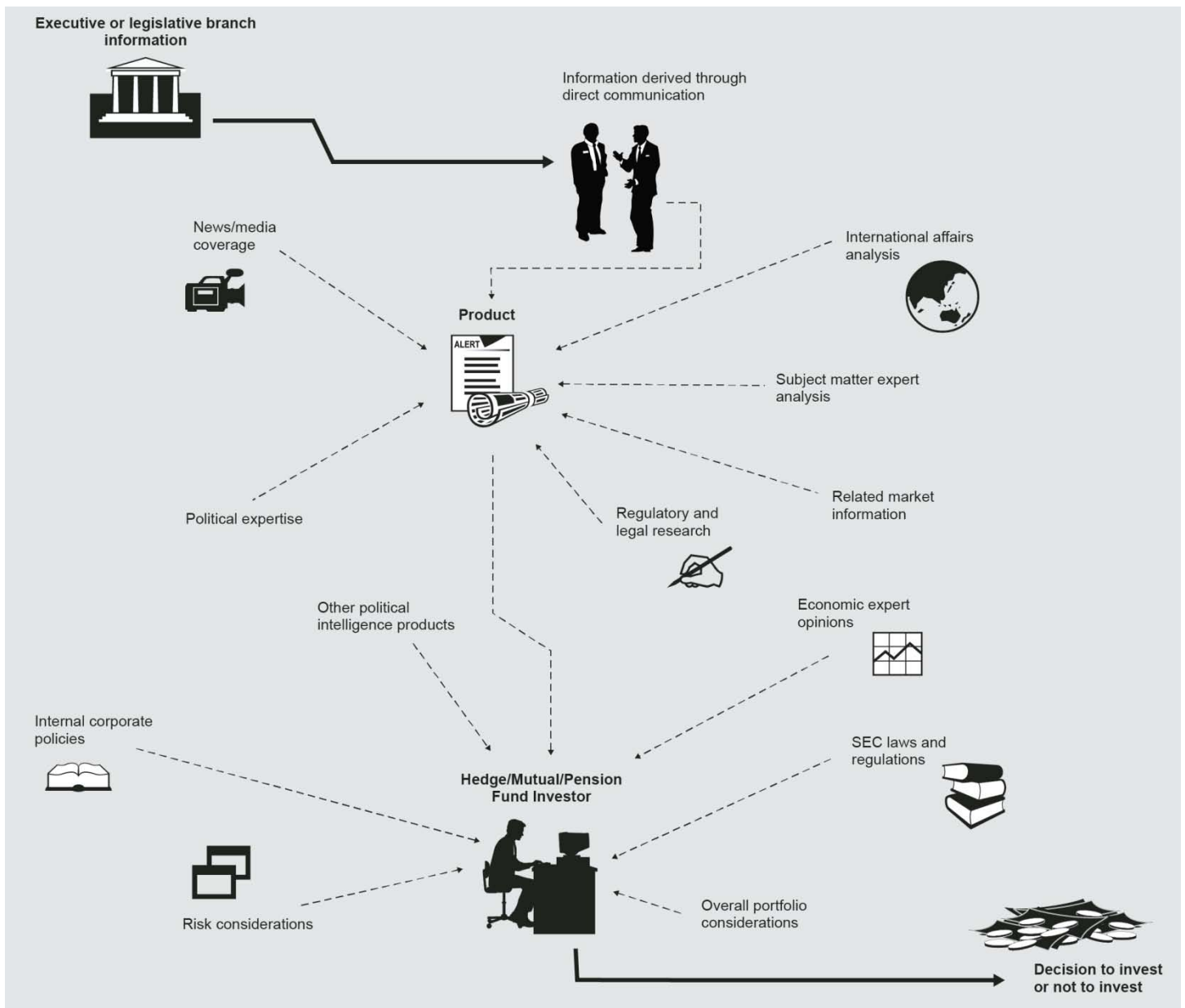
The prevalence of the sale of political intelligence is not known and is therefore difficult to quantify, as political intelligence information gathering and dissemination is often bundled with other information sources, financial compensation is usually not tied to specific sources of information or investment decisions, and consensus among political intelligence firms does not exist regarding some terms used in the STOCK Act definition of political intelligence. It is especially difficult to make a determination that a sale of nonpublic information has occurred, in part because it is not always known when information is exchanged or the timing of when nonpublic information becomes public. Nonetheless, investors do sometimes use political intelligence information and two examples that we reviewed illustrate the use of government information to gain advantage in the financial markets.

Political Intelligence Information Gathering and Dissemination Is Often Bundled With Other Information Sources

According to interviewees at seven of eight political intelligence firms and all four law firms who provide political intelligence, this information is often bundled and provided to clients with other information such as research, opinions, and policy analysis. Figure 4 illustrates the possible flow of political intelligence information. For example, one firm we interviewed provided us with a product it sent to all of its subscribers which analyzed recent developments in federal health care programs. The analysis cited information from rulemaking in the executive branch, past and current legislative activities in Congress, publicly available documents, relevant trade publications, and the firm's analysis of government actions. We were also told by five of six investors that investment decisions are most likely to be based on an overall analysis of the political climate for specific issues and not necessarily a single piece of political intelligence. For

example, according to sixteen of thirty-four interviewees, investors often rely on multiple sources of information to make an investment decision. As a result, it is difficult to link the sale of political intelligence and an investment decision to a single piece of information obtained from executive or legislative branch officials. Even when a connection can be established between discrete pieces of government information and investment decisions, it is not always clear whether such information could be definitively categorized as material or nonmaterial and whether such information stemmed from public or nonpublic sources at the time of the information exchange.

Figure 4: Illustration of Possible Flow of Political Intelligence Information



Source: GAO analysis based on relevant documents and interviews with individuals and organizations knowledgeable about industry practices.

Financial Compensation Is Usually Not Tied to Specific Sources of Information or Investment Decisions

In addition to bundling information, the nature of compensation structures for political intelligence firms is another factor complicating efforts to determine the prevalence of the sale of political intelligence. Financial compensation is usually not tied to specific sources of information or investment decisions. Consequently, there is not a reliable, consistently used data source to measure economic activity for political intelligence. In the absence of such data, we asked firms how they track the sale of information. Interviewees at six of eight political intelligence firms and three of four law firms who provide political intelligence told us that they do not specifically track the sale of political intelligence. In addition, the compensation structure for services provided by firms varies. For example, interviewees from five of the eight political intelligence firms and two of four law firms who provide political intelligence firms do not charge investors for single pieces of information. Instead, political intelligence clients generally pay firms for an overall analysis of a topic or a particular issue. Specifically, three of eight political intelligence firms and three of four law firms who provide political intelligence told us they charge a monthly retainer for provision of their products and services, and six of eight political intelligence firms and all four law firms who provide political intelligence reported that they charge hourly as services are provided, ask clients to pay an upfront fee for specific analyses, or charge a flat rate for newsletters.⁹

Quantifying the Sale of Political Intelligence Is Complicated by Lack of Consensus on Definition of STOCK Act Terms

Attempts to quantify the prevalence of the sale of political intelligence are further complicated by a lack of consensus on the meaning of some of the terminology in the STOCK Act definition, including “direct communication,” and someone “who is known to intend to use information to inform investment decisions.” Seven of eight political intelligence firms and three of four law firms who provide political intelligence stated that they had direct communication with executive branch officials or congressional staff when needing clarification or additional details on specific issues. Five of thirty-four interviewees said it was unclear if information shared by executive or legislative branch officials providing a legislative or regulatory update at an event such as a town hall meeting could be considered direct communication. Not knowing whether

⁹ Two of eight political intelligence firms and three of four law firms who provide political intelligence charge clients both a monthly retainer and hourly rates.

information is gathered by direct communication can make it difficult for firms to determine whether an exchange of political intelligence occurred.

The phrase “who is known to intend to use information to inform investment decisions” is also unclear and difficult to interpret, because investor’s intentions are not always known. For example, an investor can make a range of decisions, including a decision to take no action, in response to receipt of information. According to five of eight political intelligence firms and all four law firms who provide political intelligence, they do not know how their clients use information they provide in their investment decision-making process or if they use it at all. Specifically, some firms provide information to their clients through mass communication such as newsletters, thus making it difficult to know the extent to which, if at all, a client used their product when making an investment decision. Similarly, representatives of trade associations were unsure how their members used political intelligence information in making investment decisions. Interviewees at four of five trade associations told us that they provide guidance and information to their members when new legislation is filed or when regulations are issued that could have an impact on their members’ investment or business decisions, but are unaware of the decisions that are made based on the information provided.

Another challenge related to the definition is that firms do not always characterize their information gathering activities as political intelligence. For example, some individuals described political intelligence as policy analysis, market research, or information gathering that results from the exchange of information that could be included as a part of lobbying activities.

Timing of Information Exchange Makes It Difficult to Determine the Extent to Which Nonpublic Information Is Sold

While it is challenging to determine the prevalence of the sale of political intelligence information as a whole, we found that it is especially difficult to determine the extent to which nonpublic government information is being sold as political intelligence. This is due in part to uncertainty about when a piece of nonpublic information becomes public. It is important for a political intelligence firm to know exactly when a piece of material nonpublic information becomes public so it can pass that information along to an investor in a timely fashion, while at the same time being cautious not to violate insider trading laws. Interviewees from six of eight political intelligence firms and one of four law firms who provide political intelligence said that they have policies in place to ensure they do not knowingly sell material nonpublic information, which would be a violation

of insider trading laws. As noted earlier, federal guidance defines material nonpublic and nonpublic information to include any information that is not available to the general public which would likely be considered important in making an investment decision or information that a federal employee gains that is reasonably known to be important and therefore should not be disclosed to the general public. Because of the potential risk to their reputation as well as the possible imposition of penalties, interviewees at six out of eight political intelligence firms told us that if they suspect that information is material and nonpublic, they would not sell or distribute it until after it is known to be public.

According to ethics guidance from the House of Representatives, if information about the work of Congress is obtained during public briefings or hearings, it is then considered public information. Examples of material nonpublic information gained during the course of government service could include legislation and amendments prior to their public introduction. House guidance further provides that a good rule of thumb to determine whether information may be material nonpublic information is whether or not the release of that information to the public would have an effect on the price of a security or property.

Investors Sometimes Respond to Political Intelligence

Nonetheless, our review of economic literature and interview responses suggests that individuals and firms value political intelligence and sometimes respond to such information through investment and business decisions. Investment decisions could narrowly include an individual investor's decision regarding investments in the stock market or could be broader and also include business decisions made by a company, such as whether or not to expand existing operations or where to locate new operations.

Some economists believe that the onset of the recession in late 2007 and subsequent events in the world economy and financial markets have increased uncertainty about the direction of U.S. economic policy. A firm's finances can be affected by federal legislative and regulatory actions that alter its revenues or its costs. Uncertainty regarding the future direction of government policy may complicate firms' attempts to estimate future profitability. Firms may respond to such uncertainty by delaying investment in future productive capacity (i.e., hiring or opening a new office) while awaiting resolution of policy uncertainty. Similarly, uncertainty about a firm's profitability may also affect the price of its stock. Financial market investors may then have a comparable interest in gaining knowledge about potential government action that could affect a

firm's profitability. Three of eight political intelligence firms and two of four law firms who provide political intelligence confirmed that they have seen a rise in demand for their services in recent years, in part due to interest in policy issues such as the nation's budget uncertainty and health care reform legislation.

The asbestos liability trust fund example illustrates one instance where investors responded to government information and used this information to trade stocks. In 2005, a small group of investors used information obtained from the legislative branch about a pending announcement on the Senate floor that could affect the value of companies with asbestos-related liabilities. Investors used the information to make stock purchases in those companies before the announcement was made and the information—that the Senate would vote on a bill creating an asbestos liability trust fund—became public. In this example, investors anticipated making profitable trades by buying firms' stocks at lower prices than would prevail once all market participants knew that firms would benefit from the creation of a liability trust fund. No charges were filed, and the Senate did not pass the bill.

In another example, an FDA chemist bought, sold, and short-sold stock based on pieces of material nonpublic information, which he could access due to his position at FDA. The information allowed him to judge the direction that stock prices would change when information about a pending regulatory decision became public. The SEC investigated this case and filed a civil complaint, while the Department of Justice filed a parallel criminal case in federal court alleging violation of insider trading laws. In cases such as these, the possession of material nonpublic information provides the potential for profitable trading in anticipation of price changes once the information becomes public. When political intelligence is material and public and is disseminated through the market, its influence on prices may be evident in immediate price changes (as with the announcement of a drug approval) or may be difficult to isolate (as with a general increase in defense spending). This explains why it is difficult to determine the effects, if any, of political intelligence on financial markets.

Potential Disclosure Requirements Would Need to Balance Benefits and Costs while Also Considering Practical and Legal Issues

If Congress chose to require disclosure of the exchange of political intelligence information, then the benefits and costs of disclosure would have to be balanced while at the same time considering practical and legal issues. For example, interviewees discussed the potential benefit of increasing the transparency of political intelligence firms' activities. However, the cost of administering and enforcing disclosure of government information (such as staff and information technology resources) would also need to be considered. In addition, there are a number of practical issues regarding the structure and form of disclosure that would need to be resolved. Specifically, key definitional terms such as direct communication would need to be clarified, and the required disclosure elements—such as what the elements of disclosure include, what political intelligence information needs to be disclosed, who should file, and how often—would need to be determined. There could also be legal challenges to requiring such disclosure (based on perceived restrictions on First Amendment rights).

Some individuals we interviewed cited potential benefits of disclosing political intelligence activities.¹⁰ According to three of eight public advocacy groups, a benefit of political intelligence disclosure could be the transparency of a political intelligence firms' activities such as the source of political intelligence (executive or legislative branch), disclosure of who (investor) purchases such information, and what information was shared. However, all three interviewees with broad public policy expertise questioned whether requiring disclosure would be a matter of promoting transparency without a compelling public purpose and were not certain what specific problem disclosure would resolve. They pointed out that the information being disclosed would most likely be public information and there are already laws in place governing the protection of nonpublic information.

In addition to transparency, another potential benefit cited by SEC officials was that disclosure could potentially lead to investor protections as the nature and timing of the flow of information between a government official, a political intelligence firm, and an investor is made public through disclosure. SEC officials told us that access to information promotes investor confidence and maintains the integrity of markets. However, for

¹⁰The benefits of disclosure would depend on which activities would be required for reporting purposes. If the requirements were minimal then not all benefits discussed in this section might be realized.

political intelligence it is uncertain how helpful disclosure would be to an investor given the pace of market movements. For example, a firm's disclosure that it shared political intelligence with a large pension fund would only be helpful to other investors if the disclosure was filed and made available almost instantaneously.

Finally, according to SEC officials, disclosure could help them accomplish their mission. For example, SEC officials told us that disclosure of more information could allow enforcement staff to identify relationships or make connections between the various individuals involved in an investigation of potential insider trading. According to those officials, SEC analyzes investigative information and builds its insider trading cases by, among other things, looking for relationships between people and events that are related to a suspicious trade. SEC officials suggested that political intelligence disclosure legislation could include the name of the filer's former employer, dates of prior employment, and the dates of contact between the filer and government source.

Disclosure of political intelligence activities would also involve incurring costs for the entity processing the disclosure as well as for individuals required to disclose their activities. Congressional staff we interviewed stated that without knowing the requirements of political intelligence disclosure they could not speculate on the potential cost. However, based on their experience with administering the LDA, congressional staff said that disclosure costs most likely would include staff to administer the disclosure process, the creation and maintenance of an information technology infrastructure for disclosure, and the administrative support necessary to track registration and compliance. In addition, individuals required to disclose their activities would also likely bear the cost of compiling such information for filing.

There are also practical issues regarding the requirements and potential form of disclosure that would need to be resolved. These issues include:

- *Clarifying key terms:* Although the STOCK Act defines political intelligence, some terms in the definition are unclear. Specifically, agreement does not exist on the meaning of the phrases "direct communication" and someone "who is known to intend to use information to inform investment decisions" making it difficult for firms to determine whether an exchange of political intelligence occurred, and, as a result, uncertain as to whether they would be required to register. For example, a clear description of what constitutes direct communication would be necessary to help potential filers determine

whether a disclosure requirement applied to them. As a point of comparison, state lobbying laws define direct communication as, but not limited to, contact in person, on the telephone, by telegraph, by letter, or using electronic media. With regard to investment decisions, disclosure rules would also need to clarify whether disclosure is required for the range of decisions that an investor can make including internal business decisions and a decision to do nothing.

- *Establishing who would administer and enforce registration and reporting requirements:* Interviewees also raised practical issues regarding the structure and function of disclosure requirements with respect to who should administer a potential political intelligence disclosure requirement for both the executive and legislative branches. Specifically, two of eight attorneys and interviewees from two of eight advocacy groups discussed the importance of deciding which agency should administer political intelligence disclosure, and that disclosure should not be modeled after or be made to fit into the LDA as a default disclosure model. One of the two attorneys stated that political intelligence does not fit cleanly into the LDA and there is no public rulemaking in place to address uncertainties that may arise. The attorney suggested that the SEC, OGE or another executive branch agency that regularly handles disclosure should administer political intelligence disclosure. In addition, potential disclosure requirements would also need to identify which agency would be responsible for political intelligence enforcement.¹¹
- *Identifying the elements and characteristics of disclosure:* According to the STOCK Act definition of political intelligence three parties are involved in the exchange of political intelligence: the source of the information (e.g., the executive or legislative branch employee), the person or firm collecting the information, and the client that receives the information. Twelve of thirty-four interviewees said that who should file is a key element that would need to be determined. A representative from a media organization and two of eight attorneys—one from a law firm that gathers political intelligence—expressed concern regarding the number of contacts that might need to be disclosed, especially if a firm has hundreds or thousands of clients.

¹¹Disclosure under the Lobbying Disclosure Act is enforced by the Department of Justice (DOJ); insider trading of securities is enforced by DOJ and SEC; and insider trading of contracts of commodities and options, under the Dodd-Frank Act, is enforced by the CFTC.

We analyzed three federal laws that require disclosure of information to explore what elements may need to be considered in establishing political intelligence disclosure requirements. These laws were the LDA,¹² the Federal Election Campaign Act,¹³ and the Investment Advisers Act.¹⁴ From our analysis we found that there are at least 24 elements that would likely need to be considered, as shown in table 1. All of the elements identified were requirements in at least one of the three models we reviewed.

Table 1. Analysis of Three Federal Laws Relevant to Potential Political Intelligence Disclosure Requirements

Requirement Type	Elements for consideration
Purpose	<ul style="list-style-type: none"> Purpose of Disclosure Requirement (establish a clear definition)
Filing procedures	<ul style="list-style-type: none"> What forms to file Where to file Allows or requires electronic registration or reporting Termination of registration (e.g., if filer no longer fits requirements, a request may be made to no longer file reports)
Filing requirements	<ul style="list-style-type: none"> Who must file Who is exempt from filing Threshold requirements (only if a threshold is met) Records maintained (e.g., a record of contributions to a government official is kept and the location is reported) Registration fees
Filing time frame and deadline	<ul style="list-style-type: none"> When to file Filing deadline Frequency of filing reports

¹² The Lobbying Disclosure Act of 1995, as amended, 2 U.S.C. §§ 1601-1614.

¹³ The Federal Election Campaign Act of 1971, as amended, 2 U.S.C. §§ 431-442.

¹⁴ The Investment Advisers Act of 1940, as amended, 15 U.S.C. §§ 80b-1-80b-21.

Requirement Type	Elements for consideration
Filing content	<ul style="list-style-type: none"> • Information about the filer’s communications or contacts made on behalf of the client • Information about the client • A list of individuals who acted on behalf of the client during the reporting period (applicable if the lobbyist was engaged in political intelligence) • Expenditures or income • Campaign contributions (contributions paid by filer to a government official’s election) • Gifts (from filer to a government official)
Oversight	<ul style="list-style-type: none"> • Training or ethics course (e.g., education on new requirements and procedures for those required to report) • Restriction provisions on what filers can and cannot do • Enforcement, fines, and penalties • Audits (to monitor compliance with requirements and procedures of disclosure reports) • Public access to filer’s data (e.g., timing and format for providing information)

Source: GAO analysis of elements contained in the Lobbying Disclosure Act, Federal Election Campaign Act, and Investment Advisers Act.

Additional practical issues and concerns that would need to be considered include:

- *A robust enforcement effort may be necessary to ensure compliance:* Specifically, interviewees from four of eight political intelligence firms said firms could be less willing to register and report political intelligence activities because of concerns that public disclosure could result in a loss of their competitive advantage. In addition, seven of thirty-four interviewees stated that once political intelligence is defined some firms may attempt to avoid having their activities categorized or identified as political intelligence in order to avoid registration requirements. For example, firms may more discretely and informally provide services, may advertise their services in a way that does not indicate that they provide political intelligence information, or may join other types of businesses, such as lobbying firms, and bundle political intelligence services with other services so that they are not detected as political intelligence firms.
- *Concern about exposure of clients and clients’ interests may need to be considered:* Seven out of thirty-four interviewees had concerns regarding their clients’ interests being exposed. For example, an official from one political intelligence firm said that some of their

clients include a clause in their contracts with political intelligence firms requiring that the firm not disclose that the political intelligence firm is working for the client because they do not want their competitors to find out who gathers information for them.

- *The potential need for, and scope of, a media exemption would need to be considered:* Of the seventeen interviewees who said an exemption from disclosure may be necessary for media organizations, eight stated that an exemption from registration for and reporting on political intelligence should be established for media organizations because of the First Amendment press protection.¹⁵ However, other interviewees questioned the need for a media exemption. For example, three political intelligence firms, and one attorney from a law firm said that there should not be an exemption for media organizations because they engage in the same activities as political intelligence firms, and ask the same type of questions about the same issues that their subscribers and clients are interested in.

The definition of “media” could further complicate a possible media exemption. For example, in 2006 the Federal Election Commission (Commission) amended its campaign finance rules to clarify the applicability to the Internet. The Commission acknowledged the expansion of the Internet and noted that bloggers and others who communicate on the Internet are entitled to the media exemption in the same way as traditional media.¹⁶ The Commission did not change its rules to specifically exempt all blogging activity. Instead, it amended the media exemption to use the terms “website” and “Internet or electronic publication” with the purpose of encompassing a wide range of existing and developing technologies.

- *“Chilling” effect or slowing of communication between government, media, and political intelligence firms:* Twenty-one of thirty-four

¹⁵ In determining whether a disclosure requirement violates the First Amendment, courts generally review the relation between the disclosure requirement and the governmental interest. See *Citizens United v. Federal Election Commission*, 558 U.S. 310 (2010) (holding that the government may regulate corporate political speech through disclaimer and disclosure requirements, but it may not suppress that speech altogether); *Nat'l Ass'n of Manufacturers v. Taylor*, 582 F.3d 1 (D.C. Cir. 2009) (upholding registration and disclosure requirements on lobbyists, even though Congress has no power to ban lobbying itself).

¹⁶ 71 Fed. Reg. 18,589 (April 12, 2006).

interviewees said that disclosure of political intelligence activities could result in a potential chilling effect among government officials, the media, and political intelligence firms. For example, a political intelligence firm and an attorney from a law firm that gathers political intelligence stated that firms would likely be reluctant to share or request government information because disclosure could expose them to potential liability from an allegation of insider trading or would risk damage to their reputation from negative media coverage. Similarly, a slowdown of communication could also affect Congress as they often consult with interested parties when crafting legislation which could in some cases be considered political intelligence.

In addition, some interviewees said that they foresee legal challenges to political intelligence disclosure stemming from potential or perceived restrictions on First Amendment rights, attorney-client privilege, and an attorney's duty of confidentiality. Specifically, sixteen out of thirty-four interviewees stated that those who challenge disclosure could contend that their First Amendment rights have been violated. Four of four attorneys at law firms that gather political intelligence stated that this could be an issue because under the First Amendment there is a constitutional right to participate in the political process and that disclosure could impede that process. However, three of four attorneys at these law firms and an academic researcher said that political intelligence is not different from gathering any other kind of information and there is nothing wrong with gathering information from the government. One attorney said that gathering information is what any thoughtful individual does to analyze or form conclusions about policies, regulations, or the law.

Thirteen of thirty-four interviewees stated that a political intelligence disclosure requirement could be challenged on the basis that it contradicts the attorney-client privilege and the attorney's duty of confidentiality to his client.¹⁷ Under this rule, keeping client confidences applies not only to matters communicated to the lawyer in confidence but also to all information relating to the representation, no matter the source. However, one of eight citizen advocacy groups and one of three legal experts suggested that this argument is likely to be rejected as a similar concern was raised during consideration of the LDA. The LDA requires

¹⁷ See Rule 1.6 of the American Bar Association Model Rules of Professional Conduct, governing the client-lawyer relationship.

lobbyists, many of whom are attorneys, to report identifying information about their clients. For example, the LDA requires lobbyists to report the names of their clients, physical address, principal place of business, a general description of the client's business or activities, and the issue areas the attorney is lobbying for on behalf of the clients.

Concluding Observations

Government information helps companies and individuals understand and anticipate the potential effects of executive and legislative branch actions on business, finance, and other decisions. The financial market value of government information can hinge on the materiality and timing of such information. What is most difficult to measure is the extent to which investment decisions are based on a single piece of government information or political intelligence. Even when a connection can be established between discrete pieces of government information and investment decisions, it is not always clear whether such information could be definitively categorized as material or nonmaterial and whether such information stemmed from public or nonpublic sources at the time of the information exchange. This is in part because government information is often bundled with other information which collectively influences an investment decision and in part because the flow of information does not lend itself to quantification or ongoing documentation for the purpose of measuring industry activity.

While no laws or ethics rules specifically govern the political intelligence industry, executive and legislative branch ethics guidance and securities laws provide parameters for government officials to protect material nonpublic information. Specifically, SEC's Rule 10b-5, which applies to both the executive and legislative branches of government, prohibits the use of material nonpublic information. The SEC can open an investigation if it is suspected that a person has used material nonpublic information to trade stocks. If Congress chose to supplement existing guidance and laws with required disclosure of political intelligence information, the benefits and costs of disclosure would have to be balanced along with consideration of related practical and legal issues.

We are sending copies of this report to the Secretary of the Senate, Clerk of the House of Representatives, Senate Select Committee on Ethics, House Committee on Ethics and other interested congressional committees and members. This report is available at no charge on the GAO website at <http://www.gao.gov>. If you or your staff have any questions about this report, please contact me at (202) 512-6806 or

sagerm@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix II.

A handwritten signature in black ink that reads "Michelle Sager". The signature is written in a cursive, flowing style.

Michelle Sager
Director, Strategic Issues

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The Honorable Bob Goodlatte
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The Honorable John Conyers, Jr.
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Appendix I: Objectives, Scope, and Methodology

The Stop Trading on Congressional Knowledge (STOCK) Act of 2012 (P.L. 112-105) directed us, in consultation with the Congressional Research Service (CRS), to report on the role of political intelligence in the financial markets. The objectives for conducting our work were to describe

- the legal and ethical issues, if any, that may apply to the sale of political intelligence;
- what is known about the sale of public and nonpublic political intelligence, the extent to which investors rely on such information, and the effect the sale of political intelligence may have on the financial markets; and
- any potential benefits and any practical or legal issues that may be raised from imposing disclosure requirements on those who engage in these activities.

To address these objectives, we conducted key word searches of relevant databases and literature for studies that included political intelligence and policy research and analysis. In addition, we conducted 34 semi-structured interviews with entities that were selected to provide a range of views from those involved in providing, regulating, researching, analyzing, and receiving political intelligence.¹ Individuals provided their own perspectives rather than the official view of their firm or organization. Specifically we interviewed individuals from:

- eight political intelligence firms,
- eight non-governmental citizen advocacy or protection groups that cover public policy issues such as government transparency and openness,
- five trade associations representing pension funds and businesses (investors)
- four law firms that conduct political intelligence,
- three legal experts that specialized in the Lobbying Disclosure Act (LDA), securities law or ethics law;
- three regulatory entities—the Securities and Exchange Commission (SEC), Financial Industry Regulatory Authority, and the Commodity Futures Trading Commission
- one financial services firm (investor),²

¹We selected forty-seven entities to interview and thirteen either declined or did not respond to our request for an interview.

²In total we spoke to six investors.

- one academic researcher specializing in law reform for securities fraud, and
- one media organization.

We selected the interviewees because they were the most frequently mentioned in the results of our database and literature searches of research reports, articles, and studies. In addition, we included interviewees that were referred by one or more participants from other interviews. As such, our results may not reflect the opinions of firms not publicly identified as political intelligence firms.

We used the interviews to obtain the following types of information (depending on the type of individual or organization we interviewed):

- range of services provided by the respondent,
- differences in the use of the terms lobbying, political intelligence and policy research,
- process for collecting information,
- client relationships and services,
- legal questions pertaining to direct communication,
- legal and ethical issues that may arise from the sale of political intelligence,
- any statutes and regulations that cover political intelligence activities,
- compliance mechanisms in place to deal with legal, ethical, or regulatory issues,
- information shared that would be considered material nonpublic information,
- any benefits to requiring registration and reporting of political intelligence activities, and
- any disadvantages to requiring registration and reporting of political intelligence activities.

The information we obtained from these interviews cannot be generalized to all parties that are knowledgeable about political intelligence. Prior to conducting the semi-structured interviews, the questions were pretested with five firms and questions were reframed based on the findings from these pretests.

In addition to the semi-structured interviews, we separately interviewed ten entities including staff from the Senate Select Committee on Ethics, the House of Representatives Committee on Ethics, the Secretary of the Senate, the Clerk of the House of Representatives, the Senate Judiciary Committee, the House of Representatives Financial Services Committee, three individuals selected based on their broad expertise as private sector

leaders and their experience from previous positions in the executive and legislative branches of government, and officials from the Food and Drug Administration (FDA). The interviews were conducted to discuss legal and ethical issues that could arise if disclosure of political intelligence activities was required, as well as any compliance mechanisms in place to safeguard the disclosure of material nonpublic information. We also consulted with the Congressional Research Service and the National Academy of Public Administration as we conducted our work.

We identified executive and legislative branch examples of the prior use of government information with a resulting effect on financial markets or individual portfolios based on literature reviews, media reports, and referrals by political intelligence practitioners. For purposes of this report we focused on two examples. One example is a 2011 FDA case where a chemist misused government information and pled guilty to insider trading. The other example was a 2005 case where the Senate proposed a bill to create an asbestos trust fund. Investors traded stock based on information about the proposed bill which had not been publicly released. No wrongdoing was found. We selected the two cases and highlighted the issues associated with them in order to show potential problems that could result from the exchange of government information. In addition, we used these examples to discuss and illustrate the guidance, policies, and procedures in place for protecting and disseminating information with the potential to be defined as political intelligence from the two branches of government. For these cases we reviewed relevant legal documentation and executive and legislative branch guidance on protecting information. We interviewed FDA officials concerning the FDA case and a congressional staff member about the asbestos trust fund case.

To determine the laws and ethics rules that govern the sale of political intelligence and to determine the extent to which information being sold would be considered nonpublic information we examined legislative and executive branch ethics guidance and the interpretation and application of SEC Rule 10b-5 (related to insider trading) to identify and summarize the distinctions between public and nonpublic information. Interviews were used to obtain opinions on what information shared by Members of Congress or executive or legislative branch employees would be considered material nonpublic information. In addition, we obtained opinions about the statutes and regulations that cover political intelligence activities, and the compliance mechanisms in place to deal with legal, ethical, and regulatory issues that may arise regarding the use of political intelligence. We also met with staff from the Senate and House ethics

committees to discuss the laws and ethics rules for political intelligence activities and contacted the Office of Government Ethics.

To determine what is known about the sale of political intelligence and assess the extent to which investors rely on such information and what is known about the effect the sale of political intelligence may have on the financial markets, we used the semi-structured interviews to systematically collect testimonial evidence from the various interviewees potentially engaged in political intelligence activities. We asked interviewees about the role of various parties involved in the collection and dissemination of political intelligence, the process through which information is gathered and disseminated, client relationships and services, the types of information used to make an investment or business decision, and the extent to which political intelligence information affects financial markets. To seek economic data on the size of the political intelligence industry (i.e. measure the size of the industry), we searched for political intelligence in the industry classification systems used by federal statistical agencies to collect economic data on U.S. business establishments, the North American Industry Classification System and the Standard Industrial Classification system.

To describe any benefits or practical and legal issues that could arise from the imposition of disclosure requirements on those who engage in political intelligence activities, during the semi-structured and open-ended interviews we asked interviewees to describe any benefits or costs, as well as potential legal and practical issues, that could be raised by the imposition of disclosure requirements on those who engage in political intelligence activities. We also reviewed three federal disclosure models—the LDA, the Investment Advisers Act, and the Federal Election Campaign Act—to determine the types of requirements that would likely need to be considered for any potential disclosure model developed for political intelligence. We selected these models based on a database search of other disclosure models to ensure their potential applicability, as well as suggestions from external parties such as congressional staff and officials at regulatory agencies. Further, we selected these models because they all included a requirement to publicly disclose information, financial and non-financial data about the filer's activities, and elements that could provide useful investigative data. The elements in each of the models were ranked based on relevance, independently reviewed for objectivity, and then selected as possible elements that could be relevant for consideration of political intelligence disclosure.

Appendix II: GAO Contact and Staff Acknowledgments

GAO Contact

Michelle Sager, (202) 512-6806 or sagerm@gao.gov

Acknowledgements

In addition to the contact named above, Lisa M. Pearson (Assistant Director), Pawnee A. Davis, Rebecca S. Heimbach, Hayley Landes, Lou V. B. Smith, and Katrina D. Taylor made key contributions to this report.

Assisting with the review were Seto J. Bagdoyan, Amy R. Bowser, A. Nicole Clowers, Lawrance L. Evans, Jr., Philip G. Farah, Kirsten B. Lauber, and Susan E. Offutt

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