Office of Government Ethics
86 x 12 -- 09/08/86

Letter to the General Counsel of an Agency dated September 8, 1986

This is in response to your letter of August 21, 1986. By your letter, you raise the issue of permitted investments by the trustee of a qualified trust and inquire specifically whether the trustee of a qualified trust of one of your officials may invest in a diversified mutual fund which might have incidental interests in [certain types of organizations the direct holding of which would otherwise be restricted]. We note that [certain officials with your agency] are subject to the restrictions of [the agency's organic statute], pursuant to which they may not "hold stock in [certain types of organizations]." They are also subject to an internal voluntary guideline which prohibits members from owning [certain] marketable securities, as well as [a regulation] (relating to prohibition against holding [certain] equity securities).

This matter has been generally discussed with [an ethics officer] of your staff by [an attorney] in this Office. The situation of your agency in having an organic statute which incorporates specific restrictions on your officials' financial holdings is not uncommon. We have invariably advised agencies that it is appropriate in such situations to permit the officials to hold diversified mutual funds. In such cases, the organic statutes have been interpreted not to preclude an indirect interest, which is de minimis and incidental to the diversified fund's portfolio, even though the interest would not be permitted to be held directly. As a technical precaution, we urge that agency permission to hold diversified funds be granted by administrative waiver pursuant to 18 U.S.C. § 208(b)(2). In practice, however, we do not question the absence of such a general waiver when analyzing issues with respect to an individual's compliance with applicable statutes and regulations relating to conflicts of interest.

Accordingly, with respect to the type of situation underlying the issues you raise, we endorse the use of diversified mutual funds directly by the members of your organization as an appropriate and practical investment vehicle -- even if, at this time, it were deemed advisable to adopt a general rule by regulation under 18 U.S.C. § 208(b)(2) permitting such holdings. In our experience, an emphasis on indirect attribution (except in the case of private investment vehicles) is impractical and leads inextricably to anomalous situations involving unquestionably scrupulous conduct of the highest propriety. In the course of reviewing financial disclosure reports from your agency, we have observed occasions when holdings in diversified mutual funds included portfolios with interests which would have been prohibited as direct investments. Pursuant to the practice noted in the preceding paragraph, we considered this type of situation to be acceptable.

While we would advise that considerations of expense and convenience might argue against creating a qualified trust as a vehicle to hold diversified mutual funds, we would certify appropriate blind trust arrangements for your officials in such circumstances if that is the desire of the parties. Our position is that the statutory scheme for blind trusts does not permit constraints on the investment powers of the trustee of a qualified trust.

Prior to the enactment of the qualified trust provisions of the Ethics in Government Act of 1978 [the "Act"], there was no authoritative consensus as to what constituted a properly formulated blind trust. Consequently, there was considerable scope in individual cases to exercise initiative in shaping trust arrangements to achieve results consistent with an individualized perspective. However, the most innovative and important aspect of the trust scheme introduced by the Act involves the relationship of Federal conflicts law to trustee acquisitions. Before the Act, all holdings of a blind trust were often considered "blind" upon establishment of the trust, even though it was obvious that the trust almost certainly still contained the same assets which were placed in it by the Government official for at least some period of time. However, a qualified blind trust certified by this Office pursuant to the Act is blind only with respect to those assets secretly acquired by the trustee upon roll-over of the assets originally transferred to the trust by the Government official. For example, if General Electric shares were among the securities initially placed in a qualified blind trust, the official would be subject to Federal conflicts rules with respect to that holding, which would be attributed to him to the same extent as if the shares were held directly. Under the statutory scheme if the trustee were to sell the General Electric shares, he must inform the official and this

Office so that the official would no longer be subject to potential conflicts or appearance issues related to General Electric. However, there would be no conflicts potential with respect to acquisitions made by the trustee with the proceeds from the General Electric disposition because no one would be informed as to the trustee's activities in this regard -- there would be true blindness as to the trustee's acquisitions. The import of this principle is delineated in section 202(f)(4)(A) of the Act which provides that roll-over acquisitions shall not be "considered a financial interest of the reporting individual, for the purposes of section 208 of title 18, United States Code, and any other conflict of interest statutes or regulations of the Federal Government."

Our experience with trustees convinces us unequivocally that trustees would not be able to cope with a system that went beyond the statutory scheme and imposed restrictions on roll-over acquisitions, nor would this Office be able to cope with the many judgment calls which trustees would solicit from us to insure fulfillment of their responsibilities. Accordingly, in blind trust administration specific prohibitions against certain types of holdings which are imposed on an agency's officials by statute or regulation are used as a filtering mechanism to determine the appropriateness of the original portfolio proposed for a new blind trust. However, it does not seem an administratively feasible or workable device to superimpose these considerations on investment professionals operating beyond our system of monitoring and to whom the approach could be a quite nebulous and costly burden. Informal Advisory Letter 82 x 14 to which you refer dealt with the situation of a proposed blind trust of an official from an agency with respect to which there are no specific prohibitions on an official's holdings. We do not deem its discussion as to what might occur if specific prohibitions were to be imposed to have precedential value.

From an administrative standpoint, one of our central aims has been to establish a uniform approach to qualified trust matters, as we interpret the statutory scheme to impose a unitary standard for a properly formulated blind trust arrangement. This approach has been implemented through specific regulations specifying applicable standards and model trust drafts. In the case of qualified trusts which are newly created trust arrangements (as opposed to certifications involving trusts which were pre-existing as non-blind arrangements), the model drafts have been adapted by the parties in the course of all certifications with only such minor adjustments as are necessitated by particular circumstances.

Sincerely,

David H. Martin
Director