Order Code RS21656
Updated September 23, 2005

CRS Report for Congress

Received through the CRS Web

The Use of Blind Trusts By Federal Officials

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Summary

A blind trust, as discussed in this report, is a device employed by a federal official to hold, administer and manage the private financial assets, investments and ownerships of the official, and his or her spouse and dependant children, as a method of conflict of interest avoidance. In establishing a qualified blind trust upon the approval of the appropriate supervisory ethics entity, the official transfers, without restriction, control and management of private assets to an independent trustee who may not communicate information about the identity of the holdings in the trust to the official. The trust is considered "blind" because eventually, through the sale of transferred assets and the purchase of new ones, the public officer will be shielded from knowledge of the identity of the specific assets in the trust. Without such knowledge, conflict of interest issues would be avoided because no particular asset in the trust could act as an influence upon the official duties that the officer performs for the Government.

This report provides a brief discussion of the use of "blind trusts" by federal officials in the context of conflict of interest regulation and avoidance. Initially, it should be noted that there is *no* federal statute which expressly requires that particular federal officials place assets into a "blind trust" upon entering public service with the Federal Government. Rather, the use of a "blind trust" is one of several methods of conflict of interest avoidance under federal law and regulation. There are now uniform statutory requirements for the establishment and maintenance of blind trusts, and federal officials who are to use such devices, either voluntarily or as a remedial measure for identified conflicts of interest, must receive from their supervisory ethics office prior approval of the proposed trustee and the trust instrument to qualify the blind trust for ethics purposes.

Background: Conflicts of Interest, Disclosure and Disqualification.

The body of federal law and regulation concerning conflicts of interest and the private assets and investments of federal officials is generally directed at the concern, as expressed by the Supreme Court, "that an impairment of impartial judgment can occur in even the most well-meaning men when their personal economic interests are affected by

the business they transact on behalf of the Government."[1] The underlying principle of federal conflict of interest regulation thus embodies the axiom "that a public servant owes undivided loyalty to the Government,"[2] and that official decisions, advice and recommendations of officers of the Government be made in the *public* interest and not be tainted, even unintentionally, with influence from *private* or personal financial interests.[3] It is assumed, of course, that persons in or entering into Government service will own and possess financial assets, instruments and property to a somewhat similar extent as those comparably situated in the general population. Federal officers and employees are not, however, expected to divest themselves of all their worldly goods to avoid conflicts of interest. Rather, with respect to a federal official's personal ownership of assets, financial instruments, and income-producing property, the principal methods of conflict of interest regulation under federal law are disqualification and disclosure.

Disqualification. The principal federal conflict of interest law provides that an official who administers federal law should not take any official action on, or make recommendations concerning any particular governmental matter in which that official, or one closely associated with the official, has a personal "financial interest."[4] That is, federal officials in the executive branch of Government, other than the President or Vice President,[5] must generally "recuse" or disqualify themselves from participating in any particular governmental matter in which they have a financial interest, or in which their spouse, dependant children, partner, or business with which they are associated, has a financial interest. Executive branch officials may also be required, under regulations promulgated by the Office of Government Ethics [OGE], to recuse themselves from certain governmental matters affecting an even broader category of persons or entities with whom they have a "covered relationship."[6]

Disclosure. To enforce conflict of interest provisions, to deter the ownership of assets which may raise ethical problems, and to provide public information and assurances concerning the ethical conduct of high-level Government officials, the identity and categories of amount of one's assets, ownerships, and property (as well as other detailed financial information), must be publicly disclosed by high-level federal officials upon entering Government and every year thereafter, under the provisions of the Ethics in Government Act of 1978.[7] Generally, the identity of the assets and ownerships of a covered official, such as stocks, bonds, interests in income-producing real property, stock

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[1] *United States v. Mississippi Valley Generating Co.,* 364 U.S. 520, 549 (1960).

[2] H.Rept. 87-748, 87th Congress, 1st Session, at 3 (1961), on revised conflict of interest laws.

[3] H.Rept 87-748, *supra* at 4-6: "The attainment of one or more of these ends is impaired whenever there exists, or appears to exist an actual or potential conflict between the private interests of a Government employee and his duties as an official." *See* also, Association of the Bar of the City of New York, *Conflict of Interest and Federal Service*, at 3-4 (1960).

[4] 18 U.S.C. § 208.

[5] 18 U.S.C. § 202(c) now expressly exempts the President and Vice President from § 208.

[6] 5 C.F.R. §§ 2635.501, 2635.502.

[7] P.L. 95-521, as amended; *see* now 5 U.S.C. app. §§ 101 *et seq.* In addition to *public* disclosures required by law of high-ranking officials, *confidential* disclosures to employing agencies may be required from certain rank-and-file federal employees. 5 C.F.R. § 2634.901 *et seq.*

options, futures, mutual fund shares, and partnership shares, even those interests held in a "trust" managed by an independent trustee for the benefit of the official, are required to be disclosed by the public official in his or her disclosure reports, unless the trust meets one of the three exceptions in the law, including a "qualified blind trust."[8] For elected federal officials, that is, Members of Congress, the President and Vice President, public financial disclosure and the attendant publicity is the principal method of conflict of interest regulation, as such constitutional officers are not required by statute to disqualify or recuse themselves from the performance of their constitutional duties.[9]

Remedial Measures for Conflicting Assets.

Financial disclosure reports from covered officials, including the original entrance reports and the annual reports filed by May 15, are to be reviewed by supervisory ethics personnel to identify potential ethics and conflict problems, and to resolve any conflict of interest issues that may be raised by the ownership of certain assets by a particular public official. Remedial action which may be required by ethics officials to resolve identified conflicts of interest with respect to certain assets may include divestiture, establishment of a qualified blind trust, procurement of conflict of interest waivers, specific written recusal instruments, and requests for voluntary transfer or reassignment.[10]

Although there is not a general divestiture requirement for federal officials entering Government service,[11] the regulation of federal conflict of interest law in the executive branch provides that certain financial interests may, as noted above, necessitate some remedial measure, including divestiture, for the official to come into compliance with federal conflict of interest laws or regulations.[12] Regulations issued by the Office of Government Ethics indicate that when the ownership of a particular asset would require, under federal law or regulation, an executive branch employee's disqualification or recusal from matters "so central or critical" to his or her job that it would "materially impair[ ]" the employee's ability to perform the official duties of the office, or where it

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[8] 5 U.S.C. app. § 102(f)(1). The three exceptions are for (1) a "qualified blind trust," (2) a trust created by a third party when the official has no knowledge of the assets in the trust, and (3) a "qualified diversified trust." 5 U.S.C. app. §§ 102(f)(2), (3)-(7), and (8).

[9] Even before express statutory exemption (18 U.S.C. § 202(c)), the disqualification law was interpreted not to apply to the President and Vice President since a statutory recusal rule might interfere with such officers' constitutional duties. *See* Department of Justice letter opinion to Chairman of the Senate Rules and Administration Committee, September 20, 1974. The recusal law has never applied to Members of Congress since a forced disqualification would be tantamount to a disenfranchisement and loss of representation for the Members' constituents.

[10] 5 U.S.C. app. §106(b)(3); 5 C.F.R. § 2634.605(b)(5)(ii).

[11] While there is no law generally requiring federal employees to divest holdings, some statutes, often organic acts establishing an agency, may prohibit officials of such entities from having financial interests in the business or sector which the agency oversees. Also, an agency may by regulation prohibit or restrict ownership of certain assets by its officers and employees where, because of the mission of the agency, such interests would "cause a reasonable person to question the impartiality and objectivity with which agency programs are administered." 5 C.F.R. § 2635.403(a). In such instances, these provisions may, in effect, require the divestiture of particular assets and holdings of certain individuals in or to be appointed to such positions.

[12] 5 U.S.C. app. § 106(b)(3); *see* also 5 C.F.R. § 2634.605(b)(4),(5).

could adversely affect the agency's mission because another employee could not easily be substituted for the disqualified employee, then the official may be required by the supervisory ethics office to "divest" that particular asset.[13]

Blind Trust as Remedial or Voluntary Measure.

In some instances, the establishment of a "qualified blind trust" may be used as a conflict of interest avoidance device as an alternative to outright "divestiture" of particular assets or other measures. In addition to regular reviews and possible remediations, officials who are appointed by the President with the advice and consent of the Senate, must file a disclosure statement within five days of nomination. The statement is to be reviewed and any remedial action proposed by agency or department ethics officials, then reviewed and approved by the Office of Government Ethics, and then forwarded to the appropriate Senate committee.[14] In the executive review process, an "ethics agreement" may be entered into whereby the official, to avoid conflicts issues with respect to particular assets, agrees to certain remedial action, including the transfer of assets to a qualified blind trust, instead of divestiture or specific disqualification agreements.[15] The Senate committee initially reviewing such nomination, or the Senate as a whole, may also require from the nominee an agreement for the disposition of certain assets, including their sale or transfer to a blind trust as a condition of favorable action on the nomination regardless of, or in addition to, any executive branch actions and agreements.[16]

In addition to the establishment of a blind trust as a remedial measure for specific conflicts of interest, blind trusts may also be created by officials on their own initiative to avoid potential conflict issues and/or to ease reporting burdens. Blind trusts may be used by such Government officials even when the disqualification requirements of federal law do not apply to them, such as for Members of Congress, the President, and the Vice President. If such trusts meet the requirements of "qualified blind trusts" under federal law, then disclosure may be simplified for such officials, identifying only the trust and overall income from it, as opposed to all individual underlying assets and transactions.

Requirements of a Qualified Blind Trust.

The nature of a "blind trust," generally, is such that the federal official will have no control over, will receive no communications about, and will (eventually as existing assets are sold and new ones obtained by the trustee) have no knowledge of the identity of the specific assets held in the trust. As such, once a blind trust is established and new assets obtained, an official will not need to (and will not be able to) identify the particular assets

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[13] 5 C.F.R. § 2635.403(b). When divestiture is required, an employee should be afforded a "reasonable amount of time" to dispose of the asset; and may be able to ameliorate potential unfair tax burdens from such required sale by receiving a certificate of divestiture postponing capital gains taxes. 5 C.F.R. §§ 2635.403(d),(e), and 2634.1001 *et. seq.*

[14] 5 U.S.C. app. § 101(b); 5 C.F.R § 2634.602(a),(c)(1)(vi); 5 C.F.R § 2634.605(c).

[15] 5 C.F.R. §2634.605(c)(2)(iii)(B).

[16] Any "conditions" must be agreed to before a vote, as a confirmation vote itself may not be "conditional." Riddick and Fruman, *Riddick's Senate Procedure*, S. Doc. 101-28, at 940 (1992).

in the "blind trust" in future financial disclosure reports,[17] and such assets will not be considered "financial interests" of the official for disqualification purposes.[18] The conflict of interest theory under which the blind trust provisions operate is that since the Government officer will not know the identity of the specific assets in the trust, those financial interests could not act as influences on his or her official decisions, thus avoiding real or apparent conflicts.[19] Assets *originally* placed into the trust will, of course, be known to the official, and therefore will generally continue to be "financial interests" of the public official for conflict of interest purposes until the trustee notifies the official "that such asset has been disposed of, or has a value of less than $1,000."[20]

For a blind trust to be effective as a conflict of interest avoidance device the law recognizes that the official must be shielded from knowledge and control of the assets in the trust by making the trust truly "blind," and by assuring that the trustee is actually independent of and autonomous from direction or influence of the reporting official. The statute therefore: (1) requires the trustee to be an independent professional and not be "associated" or "affiliated" with the official or any interested party; (2) requires assets to be placed in the trust with no restrictions upon their sale or disposition at the discretion of the trustee; (3) prohibits communications from the trustee to interested parties (other than to notify when an original asset has been disposed of or becomes valued at less than $1,000, and to give information on the overall value and income of the entire trust); (4) prohibits interested parties from attempting to learn the identification of the assets in the trust; and (5) limits communications from the official to the trustee (other than instructions on distributions from the trust) except when in writing concerning general financial needs, new prohibitions on the holding of an asset, or new requirements to sell an original asset "due to the subsequent assumption of duties" of the reporting official.

Prior to 1978, there was no federal law or regulation providing rules on "blind trusts" for federal officials and their use was widely inconsistent, sometimes being created only at the insistence of a Senate committee as a requirement for approval of a nomination. The structure and effectiveness of such trusts varied widely, and there existed no oversight or enforcement mechanisms concerning their operations.[21] With the passage of the Ethics in Government Act in 1978, there were for the first time specific requirements and uniform guidelines for the establishment, maintenance, operation and enforcement of "blind trusts" for federal officials. Among the specific requirements and features of a "qualified blind trust" under federal law are the following:

Prior approval. Before a trust may be a "qualified blind trust" for conflict of interest purposes, the officer must receive prior approval of the trust instrument and the

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[17] 5 U.S.C. app. §102(f)(2)(A).

[18] 5 U.S.C. app. § 102(f)(4)(A); 5 C.F.R. § 2634.401(ii).

[19] S.Rept. 95-639, 95th Cong., 2d Sess., Report of the Committee on Governmental Affairs, "Blind Trusts," at 2-5, 13 (1978); 5 C.F.R. § 2634.401(b).

[20] 5 U.S.C. app. §102(f)(4)(A); 5 C.F.R. § 2634.401(a)(ii). An exception to this rule is provided in certain circumstances for well-diversified, marketable assets placed in a trust when the assets are not in the primary area of official responsibility of the Government officer. *Note* other requirements for this exception at 5 U.S.C. app. § 102(f)(4)(B)(i)(I) - (V).

[21] S.Rept. 95-639, *supra* at 6-7. *See* also OGE Opinion 86 x 12, September 8, 1986.

trustee from the appropriate supervisory ethics office (5 U.S.C. app. § 102(f)(3)(D)), that is, the Office of Government Ethics in the executive branch; and the Senate Select Committee on Ethics or the House Committee on Standards of Official Conduct.

Initial filing. After the trust is established the official, within 30 days, must file the executed trust agreement and a list of all assets originally transferred to the trust, and their categories of value, to the supervisory ethics office. 5 U.S.C. app. §102(f)(5)(A).

Independent trustee. The trustee must be a financial institution, a C.P.A., an attorney, a broker, or an investment advisor who is independent of the federal official or any person interested in the trust, and whose officers or employees are similarly independent. Such independence requires that the trustee and trust employees not be able to be influenced by the official or other interested parties in investment decisions, and not be "associated" or "affiliated" with, nor an employee, partner of or a relative of, the public official or any interested party to the trust. 5 U.S.C. app. § 102(f)(3)(A).

Unconditional transfer. The trust instrument must provide that the trustee of a blind trust has the freedom to be able to sell or dispose of any assets in the corpus of the trust at his or her discretion, unless a restriction on particular assets is expressly approved by the supervisory ethics office. 5 U.S.C. app. §102(f)(3)(B).

Prohibited assets. Assets originally transferred to the trust are still to be considered "financial interests" of the official for conflict of interest purposes until disposed of or their value becomes less than $1,000. 5 U.S.C. app. §102(f)(4)(A). The trust should not contain in its inception any assets which the public official is expressly prohibited from holding by federal law or regulation. 5 U.S.C. app. §102(f)(3)(C)(ii); *see* OGE Advisory Opinion 86 x 12, September 8, 1986.

No communications. The trustee is prohibited from consulting or communicating with the beneficiaries or other interested parties in the trust concerning the identity of any asset in the trust, except to inform the officer when an original asset has been disposed of or its value has become less than $1,000, as required by law. The trustee is to prepare the tax return for the trust, and no reports concerning the holdings of the trust, but rather only information on the value and income of the trust as a whole, may be made to the official and interested parties. 5 U.S.C. app. §§102(f)(3)(C), 102(f)(6)(A). The beneficiaries of the blind trust may not communicate with the trustee (other than for instructions for distributions from the trust) except in writing concerning (1) general financial needs or income of interested parties; (2) notifications of a "law or regulation subsequently applicable" prohibiting the holding of an asset, or (3) directions to sell all of an original asset which now creates a real or apparent conflict of interest "due to the subsequent assumption of duties" of the reporting official. 5 U.S.C. app. § 102(f)(3)(C)(vi).

No peeking. The beneficiaries of the blind trust may not attempt to gain information about the identity of any assets held in the trust 5 U.S.C. app. §§ 102(f)(3)(C)(vii), 102(f)(6)(B).

Enforcement. The Attorney General is authorized to bring civil action for violations of these laws concerning communications and disclosures between trustees and blind trusts beneficiaries. 5 U.S.C. app. §102(f)(6)(c).

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