DEFENSE BUSINESS BOARD

For the Secretary of Defense

Selecting Senior Acquisition Officials

DBB FY16-04

Assessing the current processes and practices for recruiting, confirming, and retaining senior officials in the acquisition workforce

PREFACE

This study, *Selecting Senior Acquisition Officials*, is a product of the Defense Business Board (DBB). Recommendations by the DBB contained within are offered as advice to the Department of Defense (DoD) and do not represent DoD policy.

The DBB was established by the Secretary of Defense in 2002 to provide the Secretary and Deputy Secretary of Defense with independent advice and recommendations on how "best business practices" from the private sector's corporate management perspective might be applied to overall management of DoD. The DBB's members, appointed by the Secretary of Defense, are senior corporate leaders and managers with demonstrated executive-level management and governance expertise. They possess a proven record of sound judgment in leading or governing large, complex organizations and are experienced in creating reliable and actionable solutions to complex management issues guided by proven best business practices. All DBB members volunteer their time to this mission.

Authorized by the Federal Advisory Committee Act of 1972 (5 U.S.C., Appendix, as amended), and governed by the Government in the Sunshine Act of 1976 (5 U.S.C. § 552b, as amended), 41 CFR 102-3.140, and other appropriate federal and DoD regulations, the DBB is a federal advisory committee whose members volunteer their time to examine issues and develop recommendations and effective solutions aimed at improving DoD management and business processes.

Assessing the Current Processes and Practices for Recruiting, Confirming, and Retaining Senior Officials in the Acquisition Workforce

TASK

In November of 2015, the Report of the Committee on Armed Services, House of Representatives, on H.R. 1735, the National Defense Authorization Act for Fiscal Year 2016 (Report 114-102) directed the Chair of the Defense Business Board (DBB) "to conduct a study of the effects of current mandates and processes regarding the determination of suitability for the selection of senior officials in the acquisition workforce...[and] further directs [the Board]…to provide recommendations to improve the Department's ability to recruit, develop, and retain highly qualified senior acquisition personnel while appropriately mitigating real and perceived conflicts of interest."

In early 2016, the Deputy Secretary of Defense directed the DBB to form a task group to complete the study. The task group was directed to: consider ethics rules, congressional committee rules, and other statutory requirements and to make recommendations to improve the depth and breadth of skills within the cadre of civilians who execute and oversee the Department's acquisition process; increase the appeal for private sector experts to accept Presidentially-Appointed, Senate-confirmed (PAS) positions; and re-validate the conflicts of interest and risk-mitigation rules. The Terms of Reference guiding this effort can be found in **Tab A**.

The Hon. Michael Bayer served as task group chair. Other task group members include the Hon. Jerry Hultin and MajGen Arnold Punaro, USMC (Ret). Capt James D'Itri, Jr., USMC, served as the task group's DBB staff representative.

PROCESS

The task group interviewed current and former senior officials and experts from within DoD, other government agencies, and the private sector. Additionally, the task group: compiled and compared management best practices from government and the private sector; reviewed applicable statutes, guidelines, rules, and DoD policies; reviewed DoD strategic

documents, reports, and pertinent data; and examined studies on management published by think tanks, businesses, and government agencies.

The task group's draft findings and recommendations were presented to the full DBB membership for deliberation and vote at the April 21, 2016 quarterly Public Meeting wherein the DBB voted to approve all recommendations offered. See **Tab B** for the task group briefing presented to and approved by the full DBB. **Tab C** has any public comments received and **Tab D** has any DoD component feedback received.

BACKGROUND

The Nation is at the opening stages of competition with two near-peer states, the long-term outcome of which will be determined, in part, by DoD's ability to deliver cutting-edge innovation to its warfighters far faster than it has ever done before. The Department's top acquisition and technology leadership are a crucial component in this long-term competition, particularly in the Department's ability to execute the Third Offset Strategy.

The type of individuals best suited to excel in the most senior acquisition positions is fundamentally different than in the past and, in the task group's opinion, is nearly impossible to recruit, given current ethics and confirmation rules. Thus, there is a need for the DoD to open the recruiting window to a broader group, one which will enable the Department to have the best qualified people for 21st century technology-dominant innovation and manufacturing jobs. Further, there is a need to not just 'tune up' the ethics and conflicts process, but rather, to establish a new ethics and conflicts architecture that attracts, rather than discourages, highly qualified individuals to serve in the Department.

Rapidly Changing Environment

Two dissimilar near-peer countries have recently emerged in competition with the U.S. The ultimate outcome of this competition will be determined in large part by the innovations of a very few. Yet, "we are entering an era where American dominance in key warfighting domains is

eroding…"[1] and so the U.S. responses are initiatives like the DoD's Third Offset Strategy, which envisions a series of strategies based on increasing our ability to create and more rapidly deploy complexity better than our potential adversaries. This strategy is innovation-driven/enabled and aims to reassert America's military technological edge against more dynamic, influential opponents. The leadership in the Department, particularly acquisition and technology leaders, must possess the necessary new skillsets to successfully execute the Third Offset Strategy.

To illustrate this point, consider the strategic context the U.S. faced in the 1960s and 1970s. This period was characterized by an Industrial Age Department that matched a similarly Industrial Age private sector, with comparatively understandable manufacturing methods, and a relatively modest innovation pace and tech-refresh cycles that exceeded our peer adversary of the time. In contrast, today's emerging strategic context is characterized by an Industrial Age Department outpaced by an Information Age private sector. Second- and third-order implications of exponential growth in technological capability disrupts conventional markets, including breakthroughs in autonomous systems, synthetic biology, nano-technology, metamaterials, and social behavior.

OBSERVATIONS

Shifting Senior Acquisition Experience

The Department must recognize how the 21st century acquisition workforce has changed with regard to the experience level they possess. Understanding this change will be key to recruiting successful acquisition executives in the future.

In the 1960s and 1970s, senior DoD acquisition officials were drawn from scientific and technical fields and came from such sources as Berkeley Radiation Laboratories, Harvard's Radio Research Laboratories, and Beckman Instruments. The list of appointed officials included the president and founder of Electromagnetic Systems Lab, Inc., director of the Lawrence Livermore National Laboratories, and a former director of Electronic Defense Lab of Sylvania/GTE.

1 Secretary of Defense Memorandum "The Defense Innovation Initiative" (OSD 080013411-14) signed Nov 15, 2014.

However, in the closing decades of the 20th century there was a shift in the type of backgrounds and experiences from which senior acquisition officials were appointed. Appointees now included a former vice president of International Paper, a Senate Appropriations Committee – Defense (SAC-D) professional staffer, an Assistant Secretary of Defense for International Policy, as well as theoretical physicists, lawyers, professors, and Rhodes Scholars. Acquisition officials have come from institutions such as Amnesty International, Human Rights First, and the Tahirih Justice Center.

Different Compensation Models for Different Time Periods

At the same time that a shift in DoD acquisition appointments changed, typical compensation for private sector executives had also changed. In the 1960s and 1970s, private sector companies tended to focus primarily on productivity and profitability in a largely U.S.-dominant domestic marketplace. Compensation for executives was composed mainly of cash that was typically tied to seniority and performance. Deferred compensation was not a common practice, and existing equity awards were in already vested stocks, making any divestitures that might be required to avoid conflicts of interest easier and less painful for appointment nominees.

Today, productivity and profitability remain paramount for determining salary for private-sector executives. However, total compensation is dramatically higher, given the prevalence of performance incentives in deferred equity, and the majority of compensation is now paid in stock, options, or other long-term structured equity packages that frequently have vesting or ‘hold’ periods. Divestiture of non-vested/deferred equity is very complicated, and often results in a loss of significant personal and family wealth. This likely serves as a significant disincentive for many otherwise-qualified DoD acquisition leadership candidates.

Trends in Defense Acquisition

When the Department of Defense was established in 1949, there was a plethora of people in the Nation’s talent pool willing and able to serve as senior acquisition officials. Public service was seen as a noble endeavor and the personal sacrifices were minimal. Beginning in the late 1990s, after a few high profile acquisition scandals, the Congress, and specifically

the Senate Armed Services Committee (SASC), began to place more stringent ethics rules on those appointed to acquisition positions within the Department. These stricter rules have the effect of discouraging highly proficient private sector executives from accepting PAS positions. This was contrary to the goal of the ethics rules which was to prevent corrupt acquisition practices. The risk to the Nation increased as the talent pool diminished in the light of these restrictions.

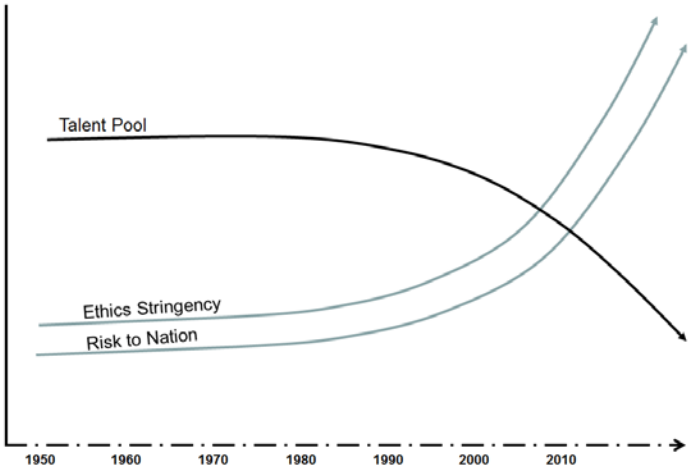


Figure 1

The total impact of the appointment of an Undersecretary of Defense for Acquisition, Technology, and Logistics (USD(AT&L)) can span up to five years, even though the average service term is only two years. The total includes the vetting, nomination, and confirmation process, which requires preparing and submitting SF-86 (security clearance) and SF-278 (financial disclosure) forms; reviews of previous tax returns, past speeches, published written work, controversial electronic posts, and travel documentation; and Senate-required paperwork and advanced policy questions (APQs). The total impact further extends to post-employment restrictions during a mandated 'cool-off' period, which affects earnings potential and reduces the likelihood of repeat government service.

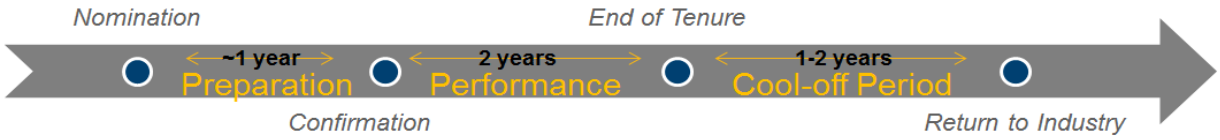


Figure 2

The most highly qualified private sector candidates often see too little return on investment for the time devoted, earnings sacrificed, and reputational risk as a result of these myriad disincentives. This results in the available pool of executives increasingly shifting toward academics, lawyers, and current government employees, while shifting away from those with C-Suite experience, high-tech industry, innovation, and large-scale business operations. As such, appealing to a sense of national service can no longer mitigate the significant sacrifices an individual must take to serve in DoD.

RECOMMENDATIONS

The DBB makes the following recommendations:

1) **Establish Qualification Standards.** The Department should identify and codify the minimum baseline qualifications for key acquisition positions in the office of USD(AT&L). Focus on developing them for the USD(AT&L) and PDUSD(AT&L) and the three Service acquisition executives. Leverage recommendations contained in the1986 Packard Commission Report which identified the Department's need to "attract and retain the caliber of people necessary for a quality acquisition program."[2] Expand the population of the Department's senior leadership beyond just the Defense Industrial Base. The following example criteria should be used as key qualifiers when considering appointments to the positions in OUSD(AT&L):

   a) Significant experience in management and oversight of large-scale manufacturing and/or acquisition in a highly technical sector of private industry.

   b) Noted achievements in driving and gaining breakthroughs from cutting-edge innovation in areas such as: autonomous systems, synthetic biology, nano-technology, metamaterials, social behavior, etc.

   c) An extensive management background and proven track record leading large-scale enterprises in innovation.

2 A Quest for Excellence. Final Report to the President by the President's Blue Ribbon Commission on Defense Management, June 1986, pg. 65.

d) The nominee should be at the top of their peer group.

2) **Pay and Compensation.** The Department should seek to implement an alternative pay and compensation structure to make senior acquisition positions more attractive. Implement a similar calculation used by DHHS and VA for various Title 38, Health Care positions, which are capped at $385,000 (aggregate pay), to offer an attractive and competitive pay rate and compensation for senior acquisition positions.

3) **Rules Adjustment**. The Department should seek to mitigate, in coordination with the leadership of the SASC, the complicated and costly financial divestment requirements that greatly reduce individual and family net wealth.

   a) Provide more options to mitigate capital gains imposition on stocks sales when divestiture is required for appointment.

      i) The current certificate of divestiture is helpful, but not desirable in some cases.

      ii) The current rules provide no solution for the loss of value due to divestiture of ownership in options of closely-held and early-stage companies.

   b) Simplify the blind trust requirements.

      i) Only *major* Defense stocks must be sold and over 5% holdings of possible non-traditional companies.

      ii) Allow funds to be invested in government pension fund basket of stocks.

   c) Establish a new set of rules and procedures that relate to today's ethics landscape, easing the ability to move between the public and private sector.

      i) The Nation needs a unique ethics construct that facilitates recruiting needed talent given the existential nature of multiple near-peer competitors.

ii) Seek the very best talent we expect to need in order to maintain a competitive advantage over our peer competitors. To do this we must recognize a 'revolving door' to recruit and later re-recruit the best and brightest acquisition leaders.

iii) Establish a set of ethical standards specific for those acquisition positions that are best served by 'successful innovators and builders' with the clear knowledge that there are multiple oversight regimes within the acquisition process to protect the integrity of the decision process.

d) Employ a more balanced OGE approach for crucial jobs in DoD.

i) Employ policies and practices that mitigate ethical risks after the official is appointed – as conducted in the American judicial and prosecutorial systems, law firms, and investment banking firms of the U.S.

ii) Include in the recusal process a method for obtaining advanced or prospective rulings as to whether the possible conflict is considered material and a suggested method of reducing/ eliminating the conflict.

iii) Provide safe-harbor status to any matter that receives a prospective ruling.

iv) Consider using a combination of full disclosure, Chinese walls, and compliance staff.

4) **Confirmation Process.** The Department should work with the SASC to adjust requirements and procedures to attract qualified candidates to positions requiring highly experienced, technically qualified, proven senior leaders from the private sector.

a) Minimize financial disincentives by reinstating blind trusts and simplifying blind pool requirements.

b) Manage capital gains from required divestiture by using a delayed procedure.

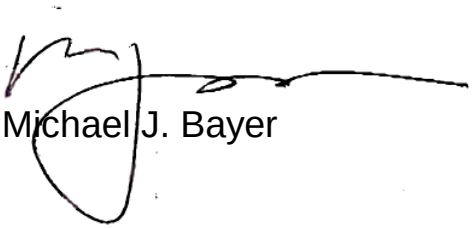
c) Alleviate restrictions on returning to industry.

d) The Senate should institute expedited procedures for acquisition nominees reported favorably by the SASC.

CONCLUSION

The time is now to make changes to the hiring process for senior acquisition officials. We are already behind in the talent race. These small number of recommendations have the potential to generate significant leverage and be a combat multiplier for the Department. We will be better positioned to access the creative and managerial talent critical to navigating the upcoming issues and decisions if the Department makes these hiring adjustments for senior acquisition officials. The benefits of attracting visionary and highly successful acquisition leaders and the efficiencies gained to our programs will have a profoundly positive effect on our ability to restore military readiness as we build a more lethal force, Secretary Mattis' first of three lines of effort. Changes to the hiring practices of senior acquisition officials also clearly supports the Secretary's third line of effort for the Department, bringing business reforms to the DoD.

On behalf of the Defense Business Board this study is respectfully submitted,



Michael J. Bayer

Defense Business Board

TAB A

TERMS OF REFERENCE

DEPUTY SECRETARY OF DEFENSE
1010 DEFENSE PENTAGON
WASHINGTON, DC 20301-1010

APR 0 2 2016

MEMORANDUM FOR CHAIRMAN, DEFENSE BUSINESS BOARD

SUBJECT: Terms of Reference - "Selection of Senior Officials in the Acquisition Workforce"

The *Report of the Committee on Armed Services, House of Representatives, on H.R. 1735, the National Defense Authorization Act for Fiscal Year 2016* (House Report 114-102), "...directs the Chair of the Defense Business Board to conduct a study of the effects of current mandates and processes regarding the determination of suitability for the selection of senior officials in the acquisition workforce. At a minimum, the assessment should examine the following:

(1) Nomination and confirmation processes;

(2) Inference of the need for, or specific direction to, potential candidates to divest themselves of financial holdings or other assets;

(3) Post-employment restrictions; and

(4) Any other statutory, regulatory, or cultural barriers that may have an unnecessarily detrimental effect on the ability of the Department of Defense to recruit, develop, and retain highly qualified senior acquisition personnel."

Therefore, I am establishing a task group under the Defense Business Board (the Board) to complete the report as requested. The report will cover these areas and any other such matters the Board determines relevant.

Task group recommendations will be presented to the Board for thorough, open consideration and deliberation in a noticed public meeting. The Board will provide its findings and recommendations to the Secretary of Defense or the Deputy Secretary of Defense for submission to Congress. The Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics will serve as the DoD liaison for this project with support from the Office of the Deputy Chief Management Officer.

In conducting its work, the Board has my full support in all requests for data or information that may be relevant to this study. As such, DoD offices are to facilitate the study by promptly ensuring that the Board staff has access to any and all personnel and information necessary to perform the study, subject to applicable security requirements.

OSD003847-16

As a subcommittee of the Board, this task group shall not work independently of the Board's charter and shall report its findings and recommendations to the Board for public deliberation and approval, pursuant to the Federal Advisory Committee Act of 1972, as amended, the Government in the Sunshine Act of 1976, as amended, and other applicable federal statutes and regulations. The task group does not have the authority to make decisions on behalf of the Board, nor can it report directly to any federal officer or representative, without the approval of the Board. Assignment of members to the task group is subject to 18 U.S.C., § 208, which governs conflicts of interest, and assigned task group members are subject to applicable ethics rules.

OSD003847-16

Defense Business Board

TAB B

PUBLIC MEETING BRIEFING

PROVIDED TO THE DEFENSE BUSINESS BOARD

DEFENSE BUSINESS BOARD

Selecting Senior Acquisition Officials

Assessing the Current Processes and Practices for Recruiting, Confirming, and Retaining Senior Officials in the Acquisition Workforce

April 21, 2016

These are the final briefing slides as approved by the Defense Business Board in the public meeting held April 21, 2016.

Task Group

"[T]he committee directs the Chair of the Defense Business Board to conduct a study of the effects of current mandates and processes regarding the determination of suitability for the selection of senior officials in the acquisition workforce...[and] further directs [the Board]…to provide recommendations to improve the Department's ability to recruit, develop, and retain highly qualified senior acquisition personnel while appropriately mitigating real and perceived conflicts of interest."

- Report 114-102 on H.R. 1735 (P.L. 114-92, signed 25 Nov 15)

Terms of Reference (TOR)

- **Selection of Senior Officials in the Acquisition Workforce**
  - Consider ethics rules, congressional committee rules, and other statutory requirements
  - Recommendations to:
    - Improve the depth and breadth of skills within the civilians who execute and oversee the Department's acquisitions process
    - Increase the appeal for private sector experts to accept Presidentially-appointed, Senate-confirmed Senior Acquisition positions
    - Re-validate the conflicts of interest and risk mitigation rules

Task Group

Problem Statement and Process

Numerous hurdles must be overcome in order for the Department of Defense to appoint individuals as Senior Acquisition Officials:

- Outdated ethics rules that no longer match the current environment
- Costly financial divestitures for the nominees
- A nomination and confirmation process that is imbued with excessive amounts of paperwork/lengthy reviews and uncertain outcomes

The result is a process that has become highly focused on selecting individuals who can get through it, rather than finding individuals who are the best qualified.

How can these hurdles be reduced?

How can the Department increase the attractiveness of service in its acquisition workforce and enhance its capacity to conduct acquisitions?

- **To fully explore this, the Task Group worked to:**
  - Understand the desired skillsets necessary for key confirmed positions
  - Understand the hurdles to service (i.e. restrictions & financial disincentives, Executive recruitment & vetting, confirmation & appointment process, post-service restrictions, etc.)
  - Assess/validate the current conflicts of interest rules and post service employment restrictions
  - Formulate recommendations

Task Group Members

- Mr. Michael Bayer (Chair)
- Mr. Arnold Punaro
- Mr. Jerry Hultin
- Capt James D'Itri, Jr., USMC (DBB staff)

Previous Efforts

- ***Making Senior Government Service More Attractive***, Business Executives for National Security (BENS), May 2015
- ***Linking and Streamlining the Defense Requirements, Acquisition, and Budget Process***, Defense Business Board, April 2012
- ***The Federal Appointments Process: The Problem and Our Proposed Solutions***, The Aspen Institute, March 2012
- ***Strengthening Administrative Leadership: Fixing the Appointments Process***, National Academy of Public Administration, 2012
- ***A Half-Empty Government Can't Govern: Why Everyone Wants to Fix the Appointments Process, Why It Never Happens, and How We Can Get It Done***, The Brookings Institute, December 2010
- ***Waiting for Leadership: President Obama's Record in Staffing Key Agency Positions and How to Improve the Appointments Process***, The Center for American Progress, April 2010
- ***Ready to Govern: Improving the Presidential Transition***, Partnership for Public Service, January 2010
- ***Department of Defense Political Appointments***, RAND Corporation, 2001
- ***To Form a Government: A Bipartisan Plan to Improve the Presidential Appointment Process***, The Brookings Institute, 2001

Bottom Line Up Front

- The nation is at the opening stages of two near-peer competitions whose long-term outcomes will be determined, in part, by ***the ability of the Department of Defense to deliver cutting-edge innovation to its warfighters far faster than it has ever done***
- Most crucial in this long competition is the Department's ***top Acquisition & Technology leadership***
- The type of individuals best suited to excel in these most senior Acquisition positions is ***fundamentally different than in the past, and near impossible to recruit given the current ethics and confirmation rules***
- There is a need to ***open the recruiting window to a broader group*** that will enable the Department to have the best people for these technology-dominant innovation and manufacturing jobs
- Further, there is a need to not just 'tune up' the ethics and conflicts process, but rather ***establish a separate enabling ethics and conflicts architecture***

Rapidly Changing Environment

Technology:

- **1960s / 1970s:**
  - An Industrial Age Department matched the Industrial Age private sector
  - Similar, relatively modest pace of innovation and tech refresh cycles that exceeded peer enemy
  - Comparatively understandable manufacturing methods

- **2015 & beyond:**
  - An Industrial Age Department with an Information Age private sector – the Department is trailing the private sector
  - 2nd and 3rd order implications of Moore's Law (exponential growth in technology's capability) disrupting conventional markets
  - Delivering breakthroughs in: autonomous systems, synthetic biology, nano-technology, metamaterials, social behavior, etc.

Rapidly Changing Environment

- Two dissimilar peers have emerged in competitions with the U.S., ***the outcomes of which will be largely determined by the innovations of a very few***
- The U.S. response are initiatives like the ***Third Offset***
  - A series of strategies based on increasing ***our ability to create and more rapidly deploy complexity*** better than our enemies
  - Innovation-driven/enabled, with the aim to ***reassert*** America's military technological edge against more dynamic, influential opponents

New skillsets are necessary to ensure the success of the Third Offset Strategy.

Shifting Senior Acquisition Experience

1960s / 1970s	2000s / 2010s
Physicists/scientists at Berkeley Radiation Laboratories	Deputy Asst. Secretary of Defense for Material Acquisition
Directors of Lawrence Livermore National Laboratories	Asst. Director of Defense Research & Engineering
Physicists at Harvard's Radio Research Laboratories	VP of ITT
Member of Canadian Nuclear Power Project	Under Secretary / Secretary of the Air Force
President & Founder of Electromagnetic Systems Lab, Inc.	Director of the National Reconnaissance Lab
Director of Electronic Defense Lab of Sylvania/GTE	President of Electronic Systems Company (McDonnell Douglas)
Scientists at Beckman Instruments	CEO of Aerospace Corporation
Earned Ph.D. in Physics at age 21	VP of International Paper
Members of the Manhattan Project	Lockheed Martin Aeronautics
Mathematicians	SAC-D Professional Staffer
Nuclear Physicists	Theoretical Physicist, Lawyers, Professors, Rhodes Scholars
Businessmen	Asst. Secretary of Defense for International Policy
Engineers	Amnesty International, Human Rights First, Tahirih Justice Center

Different Compensation for Different Times

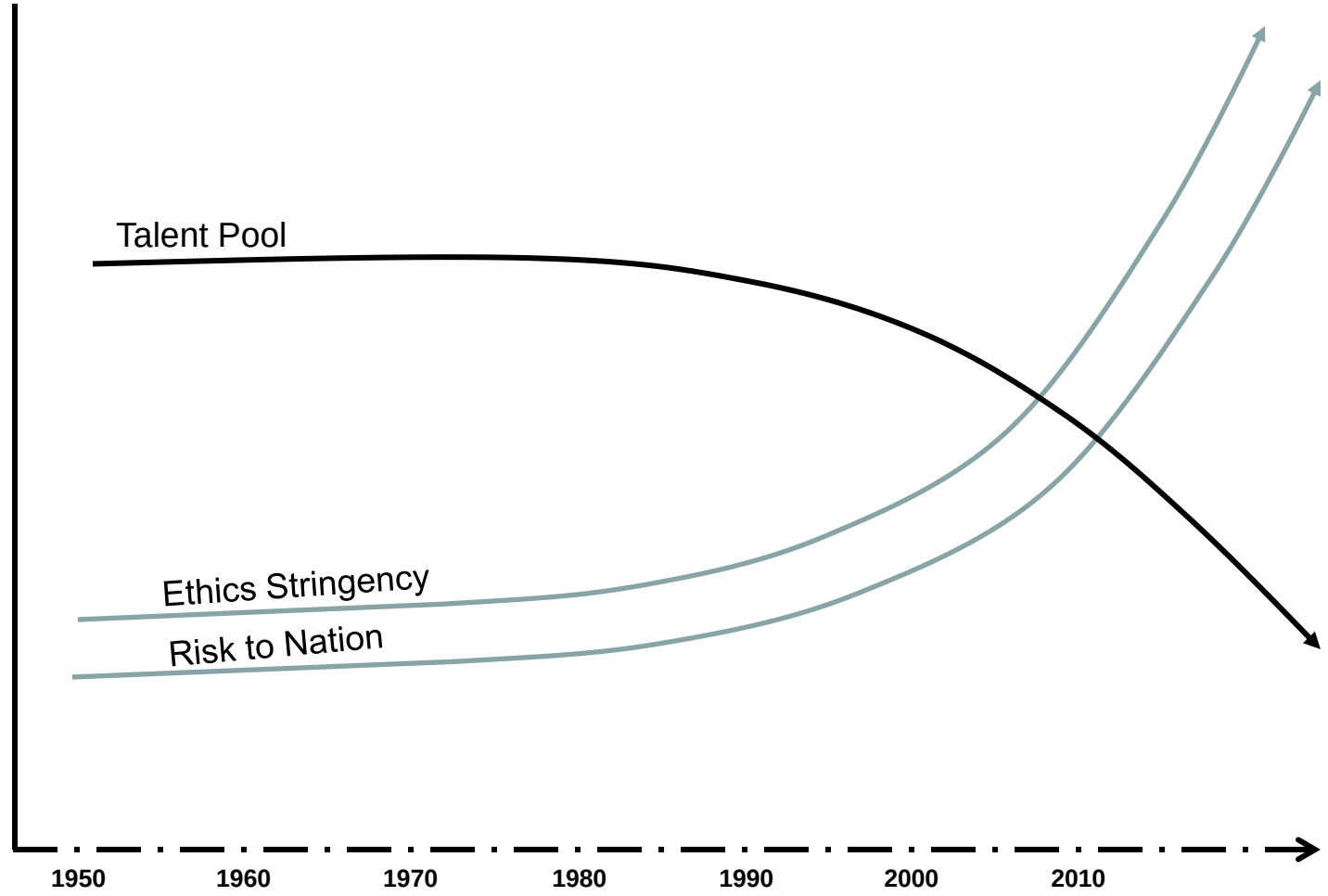
Then…

- Focus primarily on productivity and profitability in a largely U.S.-dominant domestic marketplace
- Compensation composed mainly of cash that was largely tied to seniority and performance
- Deferred compensation not then best practice
- Existing equity awards were in vested stock, making divestiture easier and less painful

Now…

- While productivity and profitability are still paramount for determining salary:
  - Total compensation is dramatically higher from performance incentives in deferred equity
  - Majority of compensation is now stock, options, or other long-term structured equity packages that frequently have vesting or ‘hold’ periods
  - Divestiture of non-vested/deferred equity is very complicated, and often results in a loss of significant personal and family wealth

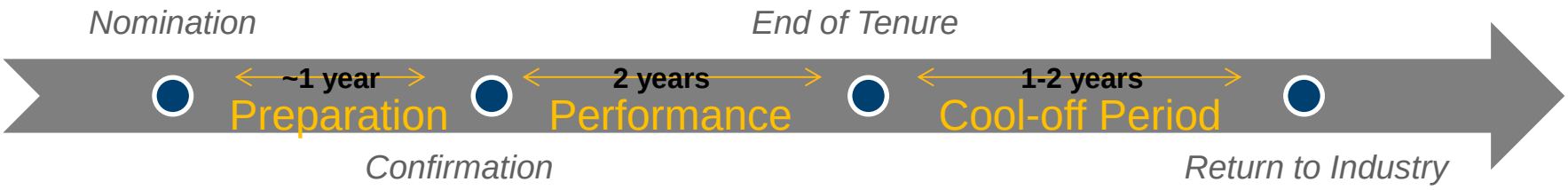
Trends in Defense Acquisition



Key Observations

Process Disincentives

- Average term of service for the USD in charge of Acquisition = 2 years
- Total impact of up to five years for an average of less than two years of service for an acquisition appointee
  - Preparation: White House Clearance, Confirmation
  - Performance: Time in the job
  - Cool-off Period: Post-employment restrictions
- Burdensome amount of paperwork in both Executive and Legislative processes
  - SF-86 for clearance, SF-278 (financial disclosure), tax returns, past speeches, written work, controversial electronic posts, travel documentation, Senate-required paperwork, Advance Policy Questions (APQs)
- Post-employment restrictions materially impact earnings potential and reduce the likelihood of repeat government service



Highly qualified private sector personnel see too little return on investment for the time devoted, earnings sacrifice, and reputational risk.

Financial Disincentives

- **Substantial pay-cut for private sector individuals with requisite experience**
  - The pay gap between senior executives in the best performing entities in the private sector has widened exponentially
  - The USD(AT&L) position is an Executive Level II, capped at $185,100
  - Other DoD Highly Qualified Expert (HQE) positions are capped at Executive Level III or $170,400
  - Government-wide Critical Position Pay Authority (CPPA) is authorized ***only in rare cases*** per 5 U.S. Code 5377, and is capped at $205,700 (Executive Level I)

Financial Disincentives (continued)

- Substantial costs associated with the required complete divestiture
  - Need to hire lawyers at significant cost to deal with paperwork and complexities
  - Must dispose of stock or options in companies with DoD contract awards of $25K or more (roughly 33,600 companies in FY 2015)
  - SASC restricts ability to use blind trusts
  - No ability to hold underwater stock or options
  - Immediate tax on capital gains, unless basis carried forward in a ‘diversified investment fund’ or U.S. treasuries
  - Divestiture results in a material reduction in personal and family net worth
- Potential loss in earned corporate retirement, and will not serve long enough to vest in any government retirement
- Onerous post-government restrictions that preclude covering/re-earning losses

All are disincentives to attracting the best and brightest of private sector acquisition expertise.

Examples of Superfluous Divestiture

- **An annually updated list of companies with Defense contracts valued at or above $25K details stocks that cannot be held by PAS officials**
  - The current list contains roughly 33,600 companies
  - Such a large number of prohibited companies produces some remarkable outcomes
- **Examples of mandated divestitures:**
  - **A Secretary of the Navy:**
    - Starwood Hotels
  - **An Assistant Secretary of Defense for International Security Affairs:**
    - Disney
  - **An Under Secretary of Defense for Policy:**
    - AT&T
  - **A Secretary of the Army:**
    - American International Group
    - Berkshire Hathaway
    - Citigroup
    - Coca-Cola
    - Pepsicola
    - Comcast Vodaphone
    - Viacom
    - Merck
    - Pfizer
    - Wells Fargo
    - AOL-Time Warner
  - **An Under Secretary of Defense for Comptroller:**
    - Berkshire Hathaway
    - Gillette
    - Wells Fargo
  - **A General Counsel of the Department of Defense:**
    - AOL-Time Warner
    - Coca-Cola
    - Disney

In recent Presidential transitions, an overwhelming number of nominees were required to divest stock – often resulting in loss of a bulk of their portfolios.

The Current Ruleset

- OGE guidelines provide narrow, 'one-size-fits-all' rules despite difference in responsibilities
  - ***Criteria:*** "Each officer or employee in the executive branch, including a special Government employee…whose position is classified above GS-15…or the rate of basic pay for which is fixed, other than under the General Schedule, at a rate equal to or greater than 120% of the minimum rate of basic pay for GS-15 of the General Schedule; each member of a uniformed service whose pay grade is at or in excess of O-7…and each officer or employee in any other position determined by the Director of the Office of Government Ethics to be of equal classification." ***Ethics in Government Act of 1978***, Title 5, U.S. Code, §2634.202
  - ***Federal conflicts of interest and related ethics laws are part of Title 18, U.S. Code***

vs. **The rest of Federal Government**

- DoD:
  - Requires extraordinary technical competency that only exists in industry
  - Leadership must have at-scale management experience
  - Outputs are of enormous consequence
- The rest primarily create policy and administer federal programs
  - ***There is a difference in the 'risk calculus' between functions***

Today's rules are solutions to yesterday's problems.

Risk Minimization in Acquisition

Primary Sources:

- Government Ethics Rules
- Senate Rules

But, there is also redundancy:

INTERNAL

- Defense Contract Audit Agency
- Defense Contract Management Agency
- Office of the Inspector General
- Program Managers

EXTERNAL

- Government Accountability Office
- Press

The Confirmation Process

- Anchored in precedent and tradition
  - Senate Armed Services Committee (SASC) strictures dating back to the 1970s are much more restrictive than the Office of Government Ethics
  - Does not allow recusals permitted under law
  - 'No recusals' requires total divestitures by the nominee and family
- No adjustments for today's compensation packages or current market conditions
- Even when approved by the SASC, the Committee is unable to 'control' or 'cajole' fellow lawmakers out of 'holds' which can run from months to years to indeterminate

Post-employment Restrictions

- **Procurement Integrity Restrictions:**
  - Cannot accept compensation, for a period of one year from a designated date, from a DoD contractor that has been awarded a competitive or sole source contract in excess of $10M, if the former official served or acted as:
    - Procuring contracting officer, source selection authority, source selection evaluation board, or chief of financial or technical evaluation team
    - Program Manager, Deputy Program Manager, or Administrative Contracting Officer
    - Officials who personally made the decision that impacted a contract in excess of $10M
- **Ethics Commitments by Executive Branch Personnel:**
  - Executive Order 13490
  - Extends 'cooling-off' period for communications with former executive agency to ***two years***
  - 'Revolving door' ban on lobbying any covered executive branch or non-career SES appointee for remainder of the Administration

Previously, Senior Acquisition positions were commonly filled by older individuals near the end of their private sector career, having made a significant amount of money, and looking to 'give back.' Today's most relevant, innovative 'best and brightest' may only be in their 40s or 50s, and have a substantial portion of their earnings potential ahead of them (post public service).

Qualification Standards in Law

The top jobs in Defense for Acquisition, Technology, and Logistics are spelled out in Title 10, U.S. Code

- **The law <u>does</u> list complex, technical roles and responsibilities that the Under Secretary must fill (among other things):**

  "Establishing policies for acquisition (including procurement of goods and services, research and development, developmental testing, and contract administration)…"

  "Establishing policies for logistics, maintenance, and sustaining support…for maintenance of the defense industrial base…"

  "The authority to direct the Secretaries of the military departments and the heads of all other elements of the Department of Defense with regard to matters for which the Under Secretary has responsibility…"

  "…is the Defense Acquisition Executive for purposes of regulations and procedures of the Department…"

  "…exercises overall supervision of all personnel…in the Office of the Secretary of Defense with regard to matters for which the Under Secretary has responsibility…"

  "…shall prescribe policies to ensure that audit and oversight of contractor activities are coordinated and carried out…"

- **But, the law contains scarce guidance in necessary backgrounds/qualifications, particularly after being modified by the National Defense Authorization Act for Fiscal Year 2008 (P.L. 110-181):**

  "The Under Secretary shall be appointed from among persons who have an extensive management background ~~in the private sector~~."

Summary of Observations

- Salary differential
- Cost of compliance
- Loss of net worth
- Eight years of commitment for less than two years of service

This results in the current available pool of executives being increasingly:

- Current government employees
- Academics
- Lawyers

While the pool shrinks for:

- Innovators
- C-Suite experience
- High tech
- Large-scale operations

Recommendation: Qualification Standards

Identify the minimum baseline qualifications for key Acquisition positions.

- **Focus on:**
  - USD(AT&L) and PDUSD(AT&L)
  - 3x Service Acquisition Executives
- **Build from the Packard Commission as a baseline**
  - The 1986 Packard Commission Report identified the Department's need to "attract and retain the caliber of people necessary for a quality acquisition program"
- **Expand the population of the Department's senior leadership beyond just the Defense Industrial Base**

Recommendation: Qualification Standards

Qualification Examples: USD(AT&L)

The following criteria shall be used as key qualifiers when considering appointments to the positions of USD(AT&L):

- Significant experience in the management and oversight of large-scale manufacturing and/or acquisition in a highly technical sector of private industry
- Noted achievements in driving and gaining breakthroughs from cutting-edge innovation in areas such as: autonomous systems, synthetic biology, nano-technology, metamaterials, social behavior, etc.
- An extensive management background and proven track record leading large-scale enterprises in innovation
- At the top of their “peer group”

Recommendation: Pay and Compensation

Implement an alternative pay and compensation structure to make the Senior Acquisition positions more attractive.

- **Implement a similar calculation used by DHHS and VA for various Title 38, Health Care positions, which are capped at $385,000 (aggregate pay), to offer an attractive and competitive rate of pay and compensation for Senior Acquisition positions**

Recommendation: Rules Adjustment

Mitigate complicated and costly financial divestment requirements that greatly reduce individual and family net wealth.

- **Provide more options to allow avoidance of capital gains at time of appointment for sales of stocks when divestiture is required for appointment**
  - Current certificate of divestiture is helpful, but not desirable in some cases
  - The current rules provide no solution for the loss of value due to divestiture of ownership in options of closely-held and early-stage companies
- **Simplify the blind trust requirements**
  - Only ***major*** Defense stocks must be sold and over 5% holdings of possible non-traditional companies
  - Allow funds to be invested in government pension fund basket of stocks

Recommendation: Rules Adjustment

Establish a new set of rules and procedures that relate to today's ethics landscape, easing the ability to move between the public and private sector.

- **Recognizing the existential nature of multiple peer competitions, the Nation needs a unique ethics construct that enables recruiting of the talent needed for peer-on-peer**
- **Recognizing that the 'revolving door' in this new world is indispensable for the Department to find, and later re-recruit, the very best talent we envisage necessary to win these peer competitions**
- **Recognizing there are multiple oversight regimes within the acquisition process and the Department writ large, establish a unique set of ethical standards for those acquisition positions that are best served by 'successful innovators and builders'**

Recommendation: Rules Adjustment

Employ a more balanced OGE approach for crucial jobs in DoD.

- **An alternative means of controlling risk is to employ policies and practices that mitigate/control such risk after the official is appointed – as conducted in the American judicial and prosecutorial systems, law firms, and investment banking firms of the U.S.**
- **The recusal process should include a method of obtaining advanced or prospective rulings as to whether the possible conflict is considered material and a suggested method of reducing/eliminating the conflict**
- **Create a practice of providing safe-harbor status to any matter that receives a prospective ruling**
- **Consider the combined use of full disclosure, Chinese walls, and compliance staff**

Recommendation: Confirmation Process

Adjust SASC requirements and procedures to make it more attractive to positions requiring highly experienced, technically qualified, proven senior leaders from the private sector.

- **Minimize financial disincentives by reinstating the use of blind trusts, and simplifying blind pool requirements**
- **Manage capital gains from required divestiture by using a delayed procedure**
- **Alleviate restrictions on returning to industry**
- **The Senate should institute expedited procedures for acquisition-related nominees reported favorably by the SASC**

Recommendations Summary

1. Identify the minimum baseline qualifications for key Acquisition positions
2. Implement an alternative pay and compensation structure to make the Senior Acquisition positions more attractive
3. Mitigate complicated and costly financial divestment requirements that greatly reduce individual and family net wealth
4. Establish a new set of rules and procedures that relate to today's ethics landscape, easing the ability to move between the public and private sector
5. Employ a more balanced OGE approach for crucial jobs in DoD
6. Adjust SASC requirements and procedures to make it more attractive to positions requiring highly experienced, technically qualified, proven senior leaders from the private sector

The Results

- **The time to make these changes is now – we are already behind in the talent race**
- **This is a small number of recommendations, but they generate significant leverage**
- **With these adjustments in place, the Nation will be able to access the creative and managerial talent necessary to lead it through these long struggles of such consequence to America and the rest of the world**

Defense Business Board

TAB C

PUBLIC COMMENTS

SUBMITTED TO THE DEFENSE BUSINESS BOARD

PUBLIC COMMENTS

As of the date of this study being published no public comments were received by the Defense Business Board for inclusion.

Defense Business Board

TAB D

DoD COMPONENT RESPONSES

PROVIDED TO THE DEFENSE BUSINESS BOARD

RECLAMAS

As of the date of this study being published no Department of Defense component responses were received by the Defense Business Board for inclusion.

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