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AIR is pleased to partner with the Buckley firm and Flourish Ventures to present the ***Financial Regulators' Dilemma: Administrative and Regulatory Hurdles to Innovation***. As technology transforms the financial sector, regulators face an enormous challenge -- even as innovation is speeding up, they are often forced to slow by down by laws and protocols that have worthy goals but also unintended consequences. The Buckley firm analyzed these barriers as a *pro bono* project for Flourish's affiliate, the Omidyar Foundation, and offers thoughts on revisiting some of these policies for the digital age.

AIR is a nonprofit venture working to help catalyze and guide a technology transformation of the financial regulatory system. This paper is the first in a series we will release in the coming months. Forthcoming reports will include a request for comments on a *Regtech Manifesto* arguing for digital redesign of the regulatory system, and a case study on the cutting-edge innovation programs of the UK Financial Conduct Authority. We will also be launching a Technology Boot Camp for regulators

Our next Tech Sprint on Financial Crime will explore solutions for the use of cryptocurrency to purchase child pornography.

Please visit our website: [www.RegulationInnovation.org](http://www.RegulationInnovation.org), and join our mailing list to receive the latest updates and participate in a growing community working toward regulatory modernization.

Jo Ann Barefoot, CEO  
David Ehrich, Executive Director

BUCKLEY

# Financial Regulators' Dilemma: **Administrative and Regulatory Hurdles to Innovation**

January 2020

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# Introduction

Developments in financial technology hold great promise to enhance the quality, delivery, and reach of consumer financial services. However, many of the laws dictating the operations of financial regulators are more than 50 years old, and in drafting these laws Congress understandably did not anticipate the digital revolution. These aging laws and administrative practices are grounded in important objectives, but they also present meaningful obstacles to financial innovation that new technology could deliver.

The Omidyar Foundation asked Buckley LLP to conduct interviews with key personnel at the principal financial regulatory agencies with the aim of identifying administrative laws and practices that present hurdles or barriers to financial innovation. We undertook this assignment, which we completed on a pro bono basis, with the cooperation and encouragement of agency personnel whom we interviewed. Our focus in this paper is not on the substantive laws designed to protect consumers and assure safe and sound operation of the financial markets, but on the administrative laws that potentially constrain regulators from promoting innovation and experimentation that stand to benefit consumers.

In preparing this report, Buckley LLP coordinated with Kabir Kumar, originally from the Financial Services Team at the Omidyar Network Foundation, now known as Flourish Ventures, and Jo Ann Barefoot at the Alliance for Innovative Regulation (AIR). Ms. Barefoot was instrumental in facilitating discussions with regulatory agencies regarding the use of new technology to enhance financial services (fintech) and its regulation (regtech). AIR's work has included initiating regtech conversations between US regulators and their counterparts in other countries and hosting a recent US regulatory hackathon in collaboration with the UK Financial Conduct Authority, with participation from dozens of US regulatory officials.

We developed this paper through candid, confidential interviews with senior personnel at financial regulatory agencies, and under ground rules that we would not reference them by name or directly attribute any comments to them. We gathered a significant amount of information on the perceived hurdles and barriers to innovation initiatives at the agencies and heard both common themes and unique perspectives.

We organized this paper by the statutes, regulations, and themes referenced in our interviews:

- Administrative Procedure Act
- Paperwork Reduction Act
- Freedom of Information Act
- Federal Advisory Committee Act
- Antideficiency Act
- Federal Acquisition Regulation
- Personnel and Hiring Policies
- Agency Culture

We do not offer any suggestions or advocate for amendments to these laws, although in some cases statutory changes may be needed to implement some of the regulators' recommendations. Where agency personnel made suggestions to remove or reduce hurdles to innovation, we have included them. We have also noted instances where our research identified potential ways to address concerns through strategies other than statutory enactments.

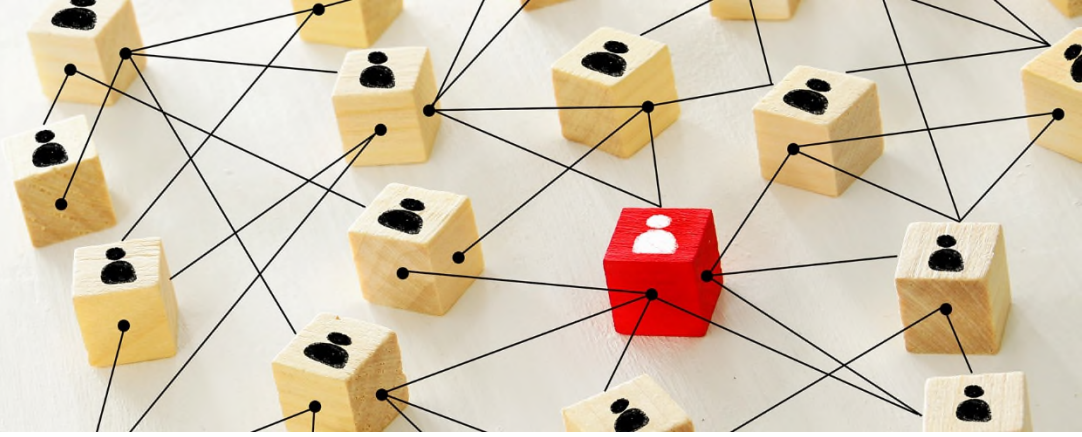
The resulting paper is an organized catalog of legal and regulatory stumbling blocks that agency personnel identified. It is our hope that it will be helpful to agency leadership and policy makers as they consider steps to modernize our financial regulatory system.

Buckley LLP



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# Administrative Procedure Act

Agency staff identified potential barriers to innovation posed by the Administrative Procedure Act of 1946 (“APA”).<sup>1</sup> The purpose behind the APA was twofold: (1) to create a comprehensive and uniform procedure of administrative practice among a growing number of diverse agencies; and (2) to curtail agency abuse of their investigative and adjudicative functions.<sup>2</sup> Since its enactment in the late 1940s, Congress has amended the APA on numerous occasions, and the Supreme Court has issued significant interpretations in landmark cases such as *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*<sup>3</sup> and *Auer v. Robbins*.<sup>4</sup> The result is a legal paradigm that federal agencies generally follow without significant deviation and which establishes accepted paths for formal and informal changes in regulation and agency policy.

## Regulatory Concerns

Under the APA, federal agencies may promulgate rules<sup>5</sup> and policies establishing requirements or expectations for industry conduct and compliance. This process is typically a time- and resource-intensive one, as it requires an agency to publish a proposal, solicit and review public comments on the proposal, make revisions as needed, and republish a rule in final form. Agency staff expressed concern that the often burdensome notice-and-comment requirements may be

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<sup>1</sup> 5 U.S.C. §§ 551 *et seq.*

<sup>2</sup> Daniel W. Morton-Bentley, *Annotation, Construction and Application of Administrative Procedure Act*, 5 U.S.C.A. §§ 500 *et seq.*—*Supreme Court Cases*, 24 A.L.R. Fed. 3d Art. 5 (2017) (referencing *Wong Yang Sung v. McGrath*, 339 U.S. 33 (1950), superseded by statute, Supplemental Appropriation Act of 1951, ch. 1052, 64 Stat. 1044 (1950), as recognized in *Ardestani v. Immigration and Naturalization Serv.*, 502 U.S. 129 (1991)).

<sup>3</sup> 467 U.S. 837 (1984).

<sup>4</sup> 519 U.S. 452 (1997); Christopher J. Walker, *Modernizing the Administrative Procedure Act*, 69 Admin. L. Rev. 629, 637 (2017) (first citing *Chevron*, 467 U.S. 837 (1984); then citing *Auer*, 519 U.S. 452 (1997)).

<sup>5</sup> Under the APA, “rule” is defined as any “agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency[.]” 5 U.S.C. § 551(4).

impacting agencies' behavior, including their willingness to revisit existing rules and work toward the promulgation of new rules:

- One agency staff member noted a strong personal commitment to the goals of the APA, but suggested that its procedural strictures could dissuade agencies from amending outdated rulemakings from years or even decades ago. As a result, rules that are not conducive to regulatory innovation may be more likely to remain in effect because agencies would have to follow the APA's lengthy and resource-intensive procedures in order to pursue a revision or rescission. Reflecting the same concern, a former senior federal official recently referred to the APA as the single biggest factor that is slowing governmental progress in the fintech area.
- Another agency staff member recommended that all final rules include a requirement for mandatory review after a certain number of years to ensure that they remained true to their original intention and that they were not slowing the development of innovation in the economy.
- The same individual noted that, while there may be anecdotal evidence of a rule impairing growth, it is difficult to pursue substantive change without supporting data. As such, this individual recommended that rules include mandatory data collection and reviews after a certain period.
- In the same vein — but taking a more forceful approach — an agency staff member recommended including mandatory sunset provisions for some new rules that would take effect if these rules were not reviewed and renewed after a certain number of years. Such a provision would force a regulatory agency to reevaluate the effectiveness of a rule prior to the sunset date, if it wished to keep the rule.

In general, agency staff viewed the APA as reducing the likelihood that an agency would be able to act nimbly to promote regulatory innovation. While they understood and agreed with the mission of the APA to ensure agency actions are transparent and consider public input, they concluded that it could have a chilling effect on the adoption of new, pro-innovation rules that could promote growth opportunities for both industries and consumers.

## **Application and Impact of the APA**

The APA sets forth the procedural requirements for federal agency rulemaking, as well as for the issuance of agency policy statements, licenses, and permits. Additionally, it provides the mechanisms for judicial review when a person has been adversely affected by agency action and sets forth the standards under which such action will be reviewed.<sup>6</sup> The APA's rulemaking requirements are relatively straightforward, though in practice they typically require a significant

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<sup>6</sup> *Id.* §§ 551 *et seq.*; Morton-Bentley, *supra* note 2.

amount of work and time by both agency staff and the general public before a rule will go into effect.

- **Informal Rulemaking.** Of the three methods of rulemaking provided by the APA, informal rulemaking is the most commonly used. Under this process, federal agencies must provide the general public with adequate notice of and an opportunity to comment on a proposed rule, typically by publishing a notice of proposed rulemaking (“NOPR”) in the Federal Register.<sup>7</sup> The NOPR must include: “(1) statement of the time, place, and nature of public rulemaking proceedings; (2) [a] reference to the legal authority under which the rule is proposed; and (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.”<sup>8</sup> The agency must then allow for an adequate opportunity for members of the public to comment, which — in the case of a significant rule — can result in a “vast rulemaking record.”<sup>9</sup> The agency will then review the entire record, addressing “significant” comments if it moves forward with a final rule. The agency will then publish its final rule in the Federal Register, and the rule will become effective no earlier than 30 days after the date it is published.<sup>10</sup> Agencies often grant more than 30 days if they believe that affected constituencies — usually industry participants — will need additional time to comply with a new rule’s requirements.
- **Formal Rulemaking.** In rare circumstances, the APA mandates a formal rulemaking process, requiring trial-like procedures in which agencies and other parties go before an administrative law judge, present evidence, and conduct cross-examination, as necessary.<sup>11</sup> The proponent of the rule has the burden of proof, and rules proposed under this process must be supported by substantial evidence. As time-consuming as the informal rulemaking process is, the formal rulemaking process is more so, as it requires significant agency resources and places the agency at a greater substantive disadvantage. As such, formal rulemaking is widely viewed as a significant impediment to issuing timely and responsive federal regulations, and agencies typically avoid it if at all possible.
- **Exempt Rulemaking.** Certain “rules” are exempt from the APA’s notice-and-comment requirements for informal rulemaking: (1) rules of agency procedure; (2) interpretive rules; and (3) general statements of policy.<sup>12</sup> Agency procedural rules are those that deal with the agency’s organization and method of operation; they do not change the agency’s basic regulatory standards, nor can they “substantially affect[] the rights of those over whom the agency

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<sup>7</sup> *Id.* § 553(b); Todd Garvey, Cong. Research Serv., R41546, *A Brief Overview of Rulemaking and Judicial Review*, at 2 (2017).

<sup>8</sup> 5 U.S.C. § 553(b)(1)–(3).

<sup>9</sup> Todd Garvey, Cong. Research Serv., R41546, *A Brief Overview of Rulemaking and Judicial Review*, at 2 (2017).

<sup>10</sup> 5 U.S.C. § 553(d).

<sup>11</sup> *Id.* §§ 556–557.

<sup>12</sup> *Id.* § 553(b)(3)(A).



exercises authority.”<sup>13</sup> Similarly, interpretive rules and general statements of policy, which generally provide nonbinding policy guidance, do not require a notice-and-comment process.<sup>14</sup>

Because the APA defines “rulemaking” as the “process for formulating, amending, or repealing a rule,” even if an agency is only planning to amend or repeal an existing rule, it generally must comply with the same notice-and-comment rulemaking procedures mandated for the initial promulgation of an informal rule.<sup>15</sup> Where an amendment or repeal results in the removal of a restriction or requirement on a regulated entity, the amendment or repeal may be excepted from the APA’s 30-day delayed effective date requirement;<sup>16</sup> however, the rest of the notice-and-comment requirements remain applicable.

## **Addressing the APA’s Barriers to Regulatory Innovation**

As the APA is a statute passed by Congress and signed into law by the president, any change to its requirements would require a new law. Congress has amended the APA more than 15 times since its initial passage seven decades ago.<sup>17</sup> However, as a purely procedural statute that does not itself impose rights or obligations on any individual, it may be difficult to make APA revisions a legislative priority. To this end, agencies and interested industry participants may want to explain the potential benefits for both the industry and its consumers from specific changes to the APA.

Given recent congressional gridlock on even routine, bipartisan matters, it may be more effective to streamline the APA through other methods, such as an executive order. An executive order need only be signed by the president to take effect. While such an order would bypass any objections from Congress, depending on its scope its legality may be subject to judicial review. Many of the APA recommendations by agency innovation staff — including the mandatory review and the sunset provisions — could be done through an executive order. For example, shortly after taking office, President Donald Trump issued Executive Order 13771, which required agencies to eliminate two existing administrative regulations for every new regulation proposed.<sup>18</sup> What executive orders offer in expediency, they lack in permanence, as an executive order can be revoked at any time — including by the next presidential administration.

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<sup>13</sup> *Pickus v. U.S. Bd. of Parole*, 507 F.2d 1107, 1114 (D.C. Cir. 1974).

<sup>14</sup> Under a recent decision, the Government Accountability Office (“GAO”) has taken the position that certain exempt rules are nevertheless subject to the Congressional Review Act (“CRA”) and thus must be presented to Congress for evaluation prior to going into effect. *See* Hon. Pat Toomey, B-329272, 2017 WL 4684778, at \*5 (Comp. Gen. Oct. 19, 2017). While we note that the additional procedural requirements of the CRA could slow the development of agency innovation rules, none of the agency innovation staffers with whom we spoke identified this as an area of concern. As such, this paper does not address the CRA’s requirements, although we recommend this as a future area of study.

<sup>15</sup> 5 U.S.C. § 551(5).

<sup>16</sup> *Id.* § 553(d).

<sup>17</sup> Walker, *supra* note 4, at 630.

<sup>18</sup> Exec. Order No. 13771, Reducing Regulation and Controlling Regulatory Costs, 82 Fed. Reg. 9,339 (Jan. 30, 2017).

Finally, the leaders of individual executive agencies could themselves pledge to establish a framework for retrospective review when formulating new regulations.<sup>19</sup> To the extent that multiple agencies commit to such reviews, these agencies could coordinate to share resources, reduce costs, and promote a coherent cross-agency regulatory scheme to encourage such reviews. For example, agencies could work with the Office of Management and Budget (“OMB”) to create a high-level organization tasked with promoting and overseeing such reviews by the agencies.<sup>20</sup> Alternatively, Congress and agencies could create a streamlined APA process for rulemakings focused on research and development; several states have created their own regulatory “sandboxes” to promote innovation, and federal agencies could follow suit by creating limited sandboxes focused on areas that are national priorities for growth. To build support for such an approach, agencies could enlist the assistance of the APA’s governing body, the Administrative Conference of the United States (“ACUS”), to assist in demanding these reforms; however, ACUS has already embraced many of the reforms discussed herein in past recommendations.<sup>21</sup> Notwithstanding, renewed recommendations for such reform could spur lawmakers (or the president) to take action on these issues.

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<sup>19</sup> See Adoption of Recommendations, 79 Fed. Reg. 75,114 (Dec. 17, 2014) (the Administrative Conference of the United States adopted Recommendation 2014-5, Retrospective Review of Agency Rules).

<sup>20</sup> *Id.*

<sup>21</sup> See, e.g., Adoption of Recommendations, 60 Fed. Reg. 43,108, 43,110 (Aug. 18, 1995) (the Administrative Conference of the United States adopted Recommendation 1995-4, Procedures for Noncontroversial and Expedited Rulemaking).



# Paperwork Reduction Act

The Paperwork Reduction Act (“PRA”)<sup>22</sup> was enacted in 1980 to reduce the public burden of federal paperwork.<sup>23</sup> The PRA: (1) established the Office of Information and Regulatory Affairs (“OIRA”) within the OMB<sup>24</sup> to carry out the mission of the PRA; (2) imposed requirements on federal agencies to manage information resources and minimize the paperwork burden imposed on the public to carry out their missions;<sup>25</sup> and (3) provided “a framework for management of information activities and information technology.”<sup>26</sup> In addition to minimizing the paperwork burden imposed on the public, the PRA’s purpose includes “ensur[ing] the greatest public benefit from and maximiz[ing] the utility of information created, collected, maintained, used, shared and disseminated by or for the Federal Government.”<sup>27</sup> However, and notwithstanding Congress’s good intentions and the many benefits arising from the PRA, agency staff have identified it as a significant hurdle to research and analysis.

## Regulatory Concerns

As a matter of good public policy, agency leaders and staff often seek a wide variety of perspectives from consumer advocates, the industry, academics, and the general public before creating or revising regulations. However, the PRA’s requirements apply to most instances in which a federal agency attempts to gather information from 10 or more individuals, including voluntary submissions of information. As a result, some agency staff have noted the inherent tension between attempts to obtain broad perspectives from the public and compliance with the strictures of the PRA.

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<sup>22</sup> 44 U.S.C. §§ 3501–3521.

<sup>23</sup> Paperwork Reduction Act of 1995, Pub. L. No. 104-13, 109 Stat 163 (1995).

<sup>24</sup> 44 U.S.C. § 3503(a).

<sup>25</sup> *Id.* §§ 3502(3), 3506(b)–(c); U.S. Gov’t Accountability Office, GAO-05-424, Paperwork Reduction Act: New Approach May Be Needed to Reduce Government Burden on Public 1 (2005).

<sup>26</sup> U.S. Gov’t Accountability Office, GAO-05-424, Paperwork Reduction Act: New Approach May Be Needed to Reduce Government Burden on Public 1 n.4 (2005).

<sup>27</sup> 44 U.S.C. § 3501(1)–(2).

This tension is particularly acute in a world where email, online surveys, social media, and websites provide an abundance of low-cost, low-impact ways for the public to make their views known. One agency staffer noted that something as simple as emailing a voluntary survey to a dozen industry groups for feedback — or even setting up an online form for comment — can trigger the PRA’s requirements and lead to a multi-agency process to ensure that the public is not unduly burdened by the agency’s information request.

Similarly, some agency staff stated that the PRA is a significant hurdle to regulatory innovation because the PRA’s lengthy approval process before soliciting public comments delays the collection of information, which in turn results in agencies receiving out-of-date information. For cutting edge and quickly developing topics, agencies recognize that, in some instances, information they receive after a mandatory PRA review would be too dated to be useful, and in light of that delay, have considered not soliciting public input at all. In the complicated area of consumer financial regulation, it is axiomatic that more information is generally better than less, yet it appears that the timing requirements and burdens imposed by the PRA may be encouraging some agencies to avoid soliciting information from the public.

Finally, some agency staff noted that while nongovernmental entities are not subject to the PRA, that does not mean that partnering with other groups is a panacea for the issues raised by the PRA. An agency that commissions a study by a group outside of the federal government triggers the PRA’s requirements, even if the request to the public came from the third party. Agencies therefore often rely upon publicly available studies conducted by groups outside the government — studies that may not ask the right questions, may be based upon flawed or incomplete data, or may be drafted to reflect the biases of the individuals who conducted the study.

## **Application and Impact of the PRA**

Under the PRA, a federal agency is not permitted to conduct or sponsor the collection of information from “ten or more persons, other than agencies, instrumentalities, or employees of the United States”<sup>28</sup> without first engaging in a specified PRA review process.<sup>29</sup> The PRA has been drafted broadly, and a PRA review is required prior to the collection of “any statement or estimate of fact or opinion, regardless of form or format, whether in numerical, graphic, or narrative form,

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<sup>28</sup> *Id.* § 3502(3)(A)(i).

<sup>29</sup> 5 C.F.R. § 1320.5(a) (2013). The PRA does not apply to information collections during a federal criminal investigation or prosecution, during a civil action to which the United States is a party, or during the conduct of intelligence activities. 44 U.S.C. §§ 3502(3)(B), 3518(c)(1). In addition, information collections from “agencies, instrumentalities, or employees of the United States” in their official capacities are generally not subject to the PRA, unless those collections are for “general statistical purposes.” 44 U.S.C. § 3502(3)(A); *see also* Memorandum from Cass R. Sunstein to Heads of Executive Departments and Agencies, and Independent Regulatory Agencies, Office of Mgmt. and Budget, Exec. Office of the President 3–4 (Apr. 7, 2010), [https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/assets/inforeg/PRAPrimer\\_04072010.pdf](https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/assets/inforeg/PRAPrimer_04072010.pdf) (hereinafter Information Collection Memorandum).

and whether oral or maintained on paper, electronic or other media.”<sup>30</sup> Given this scope, the PRA review process applies to almost all requests for public information that an agency would make.

The PRA clearance process requires that the agencies conduct a review that includes an evaluation of the need to collect information; a description of the information to be collected; a plan for the collection; a specific, objectively supported estimate of burden; an evaluation of whether the reporting burden can be reduced by electronic or other technological collection techniques; a test of the collection of information through a pilot program; and a plan for the efficient and effective management and use of the information to be collected, including necessary resources.<sup>31</sup> The agency must then evaluate the public comments received regarding whether the proposed collection of information is necessary for the agency’s performance; the accuracy of the agency’s estimate of the burden of the proposed collection of information; the quality, utility, and clarity of the information to be collected; and ways to minimize the burden of the collection of information on those who are to respond.<sup>32</sup>

After evaluating the public comments, the agency must submit the proposed collection of information to the OMB along with an agency certification; an explanation for a decision that it would not be appropriate for the proposed collection of information to display an expiration date; an explanation for a decision to provide a payment or gift to those responding; a statement indicating whether the collection would use electronic or other technological collection techniques; a summary of the public comments received and actions taken by the agency in response to the comments; and copies of the pertinent statutory authority, regulations, and such related supporting materials as OMB may request.<sup>33</sup> The agency must then publish a notice in the Federal Register stating that the agency has made a submission for a proposed collection of information.<sup>34</sup> The following is a visual depiction of the PRA review process:



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Federal agencies must receive OMB approval before conducting or sponsoring a collection of information.<sup>36</sup> Generally, OMB has 60 days to approve or disapprove a proposed collection

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<sup>30</sup> 5 C.F.R. § 1320.3(h).

<sup>31</sup> *Id.* §§ 1320.5(a)(1)(i), 1320.8(a).

<sup>32</sup> *Id.* §§ 1320.5(a)(1)(ii), 1320.8(d)(1), 1320.11

<sup>33</sup> *Id.* §§ 1320.5(a)(1)(iii), 1320.8, 1320.9, 1320.11, 1320.12.

<sup>34</sup> *Id.* § 1320.5(a)(1)(iv).

<sup>35</sup> Information Collection Memorandum, *supra* note 29, at 4.

<sup>36</sup> 5 C.F.R. §§ 1320.5(a)(2)–(3), 1320.5(b)(1).

request.<sup>37</sup> Approved requests are assigned a control number<sup>38</sup> and an expiration date not to exceed three years.<sup>39</sup> In addition, the agency must inform potential respondents that responding to the collection of information is not required unless the collection displays a currently valid control number “in a manner that is reasonably calculated to inform the public.”<sup>40</sup>

Based on the foregoing, it may take six to nine months from the time that an information collection plan is developed to obtain final approval from OMB — and this does not include time spent identifying targets for information collection or preparing to start the PRA approval process. Requests may be outdated before the agency can even begin to collect information. Accordingly, it is no surprise that certain agencies may not feel motivated to request information and proceed through the PRA approval process.

OMB issued a 2010 memorandum regarding the use of social media and online communications to obtain information from the public.<sup>41</sup> This guidance provided some clarity, but retains a number of the formal structures of the PRA, and in so doing also perpetuates areas of concern identified during our interviews with agency staff.<sup>42</sup>

## Addressing the PRA’s Barriers to Regulatory Innovation

Similar to other statutes, the PRA is a federal statute that may only be amended by Congress. In fact, there has been some movement in the Senate to amend the PRA. Senator Claire McCaskill (D-Mo) in 2017 introduced a bill to amend the PRA to exempt the agency’s collection of information that is voluntary feedback — i.e., a submission of information, opinion, or concern voluntarily made by a specific person relating to a particular service of, or transaction with, an agency that specifically solicits the feedback — from the agency’s authority to prescribe policies, rules, regulations, and procedures for federal information resources management activities.<sup>43</sup> The bill passed the Senate in November 2017 but was never passed by the House. More recently, Senator Maggie Hassan (D-N.H.) and Representative Brian Fitzpatrick (R-Pa.) each sponsored substantially

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<sup>37</sup> *Id.* § 1320.10(b); U.S. Gov’t Accountability Office, GAO-05-424, Paperwork Reduction Act: New Approach May Be Needed to Reduce Government Burden on Public, at 10 (2005).

<sup>38</sup> Information Collection Memorandum, *supra* note 29, at 2 n.7. The OMB Control Number is two four-digit codes separated by a hyphen. The first four digits identify the sponsoring agency and bureau, and the second four digits identify the particular collection.

<sup>39</sup> 5 C.F.R. § 1320.11(j); U.S. Gov’t Accountability Off., GAO-05-424, Paperwork Reduction Act: New Approach May Be Needed to Reduce Government Burden on Public, at 10 (2005).

<sup>40</sup> 5 C.F.R. § 1320.5(b)(2).

<sup>41</sup> Information Collection Memorandum, *supra* note 29.

<sup>42</sup> *Id.*

<sup>43</sup> Federal Agency Consumer Experience Act of 2017, S.1088, 115th Cong. (2017), <https://www.congress.gov/bill/115th-congress/senate-bill/1088?q=%7b%22search%22:%5b%22customer+service+data%22%5d%7d&r=3>.

similar bills adopting the same title and key components.<sup>44</sup> The Senate passed Senator Hassan’s bill in July 2019.

In practice, federal agencies are likely the most promising avenue to support revisions to the PRA by Congress, as they are in the best position to coordinate and advocate for revisions that would alleviate information collection obstacles while protecting the public from unnecessarily burdensome requests.

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<sup>44</sup> Federal Agency Customer Experience Act, S.1275, 116th Cong. (2019); Federal Agency Customer Experience Act, H.R. 2586, 116th Cong. (2019).



# Freedom of Information Act

The Freedom of Information Act (“FOIA”)<sup>45</sup> was enacted in 1966 to create a mechanism for granting public access to government documents and information concerning public policy and administrative regulation.<sup>46</sup> While FOIA promotes the fundamental democratic principle of allowing the public access to information about its government, it can create challenges for regulators seeking to facilitate innovation within their own ranks or in a specific industry — particularly when such innovation involves the collection, analysis, and use of sensitive or confidential information. Regulators cite FOIA as a significant impediment to companies’ willingness to share confidential and proprietary information, as well as a significant deterrent to agencies engaging in new activities or community outreach that, if publicized, could send distorted or inaccurate messages to an industry or the public at large.

## Regulatory Concerns

Agency staff have indicated that the possibility of receiving a request for information or documents under FOIA impacts — on some level — nearly every aspect of agency decision-making, both in the regulatory sphere and elsewhere. For example, agency staff noted that FOIA concerns affect not only overall innovation programs by agencies, but also smaller process-driven choices such as the collection of documents and how agencies memorialize their policy choices. The knowledge that a member of the public may ultimately see and publish this information can lead regulators to proceed with sometimes unnecessary caution and to avoid addressing issues candidly for fear their views may be taken out of context. Agency staff said these concerns can slow the development of good policy.

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<sup>45</sup> 5 U.S.C. § 552.

<sup>46</sup> Fred H. Cate et al., *The Right to Privacy and the Public’s Right to Know: The “Central Purpose” of the Freedom of Information Act*, 46 Admin. L. Rev. 41, 42–43 (1994).



With respect to regulatory innovation in particular, agency staff noted that FOIA poses the following concerns:

- One agency staff member explained that FOIA is always at the forefront of decision-making about even routine tasks such as emails and meeting invitations, and can affect which entities they meet with and the topics covered during a meeting. This can chill agency outreach to industry participants if there is a possibility that such outreach could have an undesirable impact on a regulated industry, markets, or the public at large.
- Another agency staff member said industry participants assert their reluctance to engage with regulators for fear that information provided to the government could be released under FOIA. In many instances, innovation-related information shared with agency innovation staff is both proprietary and valuable. While a company may be willing to share such key information with a regulator to inform policy choices, it would not do so at the expense of sharing this information with competitors. For example, a business may opt not to share with a regulator the algorithm underlying a new underwriting technology because of the possibility that the algorithm could be publicly released in response to a FOIA request — potentially subjecting the business to competitive and legal risk.
- Agency staff said companies view with skepticism exemptions within FOIA designed to protect propriety information. These FOIA exemptions are broad and are subject to interpretation, leading to varying decisions about their application. Current agency staff might grant an exemption not recognized by future agency staff. Companies also cannot predict with certainty how a court would treat the information in the event of a FOIA lawsuit.
- Another agency staffer raised the question of how FOIA would apply in the context of an innovation competition hosted by a federal agency. Since the purpose of these competitions is to demonstrate how various ideas or processes work, it is uncertain whether information obtained during these competitions should be viewed as a confidential trade secret or commercial information exempt from disclosure under FOIA.

In sum, regulators suggested that FOIA poses an obstacle to both their agencies and the companies they regulate in obtaining meaningful information upon which to build a regulatory innovation agenda.

## **Application and Impact of FOIA**

FOIA requires federal agencies to grant the public access to various types of information regarding their organization, governance, opinions, policy statements, and other information and

documents.<sup>47</sup> Perhaps the best-known provision in FOIA relates to public access to agency records upon request:

[E]ach agency, upon any request for records which (i) reasonably describes such records and (ii) is made in accordance with published rules stating the time, place, fees (if any), and procedures to be followed, shall make the records promptly available to any person.<sup>48</sup>

FOIA also requires that agencies maintain regulations setting forth the process for handling requests and establishing any fees.<sup>49</sup>

While FOIA grants broad public access to agency information, there are significant exceptions to the law’s disclosure requirements that can apply to information about financial institutions and other regulated entities.<sup>50</sup> These include:

- Matters that are “trade secrets and commercial or financial information obtained from a person and privileged or confidential,”<sup>51</sup>
- Certain “records or information compiled for law enforcement purposes”;<sup>52</sup> and
- Information “contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions[.]”<sup>53</sup>

While one might interpret these exceptions as being sufficiently broad to assuage a regulated entity’s fears that proprietary information will not be subject to public scrutiny, FOIA has been used in the past by competitors seeking to gain an advantage in the marketplace. Indeed, by the second decade following FOIA’s enactment, “[b]usinesses had learned that the FOIA could be used to gather information about competitors that could be used to gain a commercial advantage. In fact, the vast majority of the FOIA requests were made by business executives or their lawyers . . . .”<sup>54</sup> Even today, so-called “commercial requesters” make up a significant, and in many cases the largest, portion of FOIA requesters for a number of agencies.<sup>55</sup> Similarly, FOIA can also be used as a tool by litigants to obtain information about a company outside of the standard discovery process, creating not only competitive but also legal exposure from providing information to the government.

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<sup>47</sup> 5 U.S.C. § 552(a).

<sup>48</sup> *Id.* § 552(a)(3)(A).

<sup>49</sup> *Id.* § 552(a)(4).

<sup>50</sup> *Id.* § 552(b).

<sup>51</sup> *Id.* § 552(b)(4).

<sup>52</sup> *Id.* § 552(b)(7).

<sup>53</sup> *Id.* § 552(b)(8).

<sup>54</sup> Cate, *supra* note 47, at 46.

<sup>55</sup> Margaret B. Kwoka, *FOIA, Inc.*, 65 Duke L.J. 1361, 1381 (2016).

Ultimately, a court would be the final arbiter in the event that a requester disputes an agency's reliance upon a FOIA exemption. The combined unpredictability of agency and judicial decision-making likely contributes to the uncertainty surrounding information that may be subject to disclosure under FOIA, particularly when the information reflects innovative efforts by one or more companies that could be used by a competitor.

## **Addressing FOIA's Barriers to Regulatory Innovation**

As FOIA is a federal statute, only Congress is in a position to amend its language to strengthen or clarify the exceptions or procedure for requesting disclosure of information.<sup>56</sup> Within the bounds of the statute, however, agencies have opportunities to make FOIA more protective of agency deliberations, proprietary industry information, and innovation. Individual agencies — or multiple regulatory agencies acting in concert — may want to consider coordinating amongst themselves to develop consistent, reasonable policies for interpreting FOIA exemptions. Such policies should be both formalized and publicly available and should balance the need for public disclosure of relevant information with the goal of fostering innovation through partnering with regulated entities in information-sharing endeavors.

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<sup>56</sup> While there are regulations within individual agencies that implement FOIA, these regulations in large part — and in particular, in providing exemptions to FOIA — borrow heavily from the statutory language. Thus, any meaningful change to FOIA likely would need to begin with a revision to the overall statutory text.



## Federal Advisory Committee Act

Advisory committees have long served as a valuable resource for federal officers and agencies. In the 2019 Fiscal Year alone, federal agencies were supported by over 1,000 advisory committees, with over 60,000 members. The Federal Advisory Committee Act (“FACA”), in its attempt to establish controls and openness regarding the use of informal advisors, has inadvertently created barriers to regulatory policymakers obtaining the advice of citizen groups and industry representatives alike.

### Regulatory Concerns

Agency staffers have indicated that FACA, although well-intentioned, is a hindrance to collaborative efforts. The question of when to invoke FACA and comply with its requirements is a cause of concern to agency staff. If agency staff want to meet regularly or have multiple meetings with groups in a particular industry, they have to consider whether such groups are considered advisory committees, which likely implicates FACA. Some have argued that FACA’s broad definition of an “advisory committee straightjackets even the most commonplace government dealings.”<sup>57</sup> As a result, some agency staff have avoided interactions with outside advisors — even when their insights potentially could have been valuable. This likely results in agency staff receiving limited, if any, crucial information from industry participants on questions regarding financial technology in practice. Further, judicial interpretations have not served to clarify FACA.<sup>58</sup> As a result, agency leaders and staff have been left with the unfortunate task of interpreting this criteria under the potential threat of litigation.

FACA’s provisions also have limited the frequency and productiveness of advisory meetings. The openness requirement prevents committees from providing valuable insight to agencies in a timely fashion. In order to comply with FACA’s advance notice requirement, committees must

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<sup>57</sup> Rebecca J. Long & Thomas C. Beierle, *The Federal Advisory Committee Act and Public Participation in Environment Policy*, at 13 (Resources for the Future, Discussion Paper No. 99-17, 1999).

<sup>58</sup> *Id.* at 12–13.

wait fifteen days after publishing a notice to hold a meeting. During meetings, agency staff is cognizant of the publicness of their discussion, which may negatively impact candid discussions.

## Application and Impact of FACA

Prompted by efficiency and governance concerns, FACA was enacted in 1972 to formalize the guidelines for the establishment, operation, and termination of federal advisory committees. An “advisory committee” under FACA means any “committee, board, commission, council, conference, panel, task force, or other similar group, or any subcommittee” that is “established or utilized” by a federal agency and has at least one non-federally employed member.<sup>59</sup> In selecting its members, a committee must maintain a balanced representation of views.<sup>60</sup>

Advisory groups can be created by Congress, the president, or a federal agency for the purpose of obtaining expert advice to aid in decision-making. Prior to operation, an advisory group charter must be filed with a high-level agency official, Congress, the Library of Congress, and the General Services Administration (“GSA”) by a designated agency official.<sup>61</sup> The charter must first, however, undergo several levels of review. Once the GSA’s Committee Management Secretariat — the entity charged with committee oversight — has completed its review, a notice of establishment must be published in the Federal Register. The charter can be filed fifteen days following the publication.<sup>62</sup>

At a high level, advisory groups subject to FACA are required to:

- “Provide advice that is relevant, objective, and open to the public;”<sup>63</sup>
- “Act promptly to complete their work;”<sup>64</sup> and
- “Comply with reasonable cost controls and record keeping requirements.”<sup>65</sup>

To ensure compliance with the above requirements, all advisory committee meetings must be open and accessible to the public with limited exceptions.<sup>66</sup> Ample notice of these meetings must

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<sup>59</sup> 5 U.S.C. App. 2 § 3(2).

<sup>60</sup> *Id.* § 5(b)(2).

<sup>61</sup> 41 C.F.R § 102-3.70(a).

<sup>62</sup> GSA Comm. Mgmt. Secretariat, GSA Office of Governmentwide Policy, Preparing Federal Advisory Committee Charters (2008), [https://www.gsa.gov/cdnstatic/Preparing\\_Federal\\_Advisory\\_Committee\\_Charters\\_vers\\_4.pdf](https://www.gsa.gov/cdnstatic/Preparing_Federal_Advisory_Committee_Charters_vers_4.pdf).

<sup>63</sup> U.S. Gen. Servs. Admin, The Federal Advisory Committee Act (FACA) Brochure (Feb. 2, 2019), <https://www.gsa.gov/policy-regulations/policy/federal-advisory-committee-management/advice-and-guidance/the-federal-advisory-committee-act-faca-brochure>.

<sup>64</sup> *Id.*

<sup>65</sup> *Id.*

<sup>66</sup> 5 U.S.C. App. 2 § 10(a)(1). Exceptions to the openness requirement are articulated in the Government in the Sunshine Act of 1976. Pub. L. 94-409 (1976) (codified at 5 U.S.C. § 552b).

be provided by publication in the Federal Register.<sup>67</sup> Advisory groups are required to keep detailed minutes of meetings which, at a minimum, must include: “a record of the persons present, a complete and accurate description of matters discussed and conclusions reached, and copies of all reports received, issued, or approved by the advisory committee.”<sup>68</sup> This information, along with all other documents utilized by the committee, must subsequently be made available for public inspection.<sup>69</sup>

All committees, as required by FACA, are terminated two years after its effective date (*i.e.*, the date the charter was filed with the Senate and House).<sup>70</sup> This “sunset provision” encourages advisory groups to satisfy their duties in a timely manner. The GSA, until the completion of the two-year period, conducts an annual review of a committee to ensure adequate progress is made and resources are being used appropriately. Following termination, records must remain publicly accessible.

## **Addressing FACA’s Barriers to Regulatory Innovation**

Much of agency staff’s concerns with FACA result from the applicability of the statute. Any effort to address this issue requires congressional action. Congress may consider clarifying which committees must adhere to FACA’s provisions. This amendment may come in the form of a blanket applicability of its requirements. By requiring all advisory committees to comply with FACA’s requirements, the vagueness issue becomes moot.

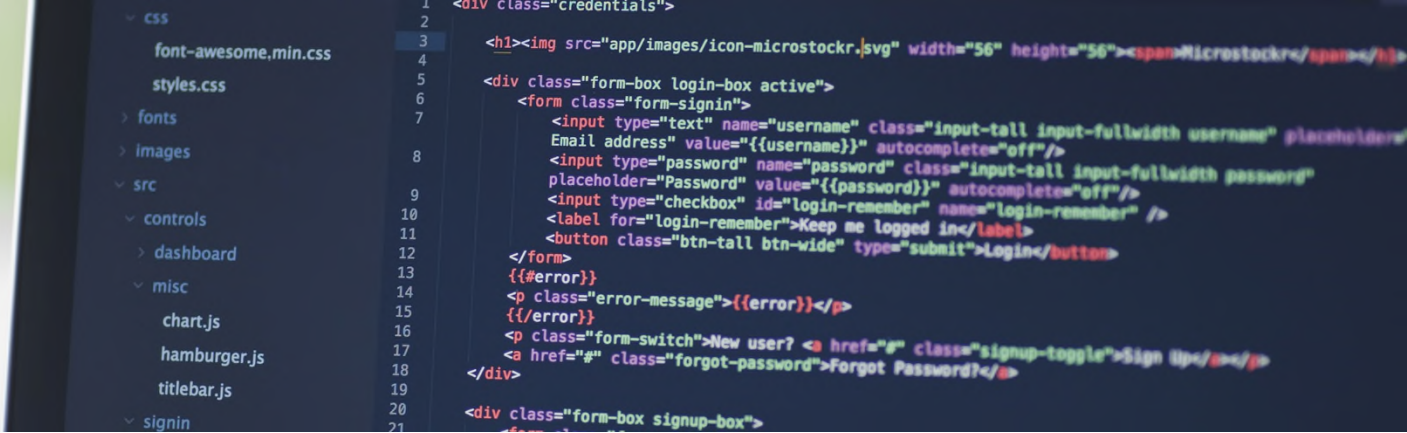
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<sup>67</sup> 5 U.S.C. App. 2 § 10(a)(2). Ample notice is defined as fifteen calendar days prior to the convening of an advisory meeting. 41 C.F.R. § 101-6.1015(b)(1). This requirement is only applicable to meetings in which an agency is seeking advice from a group acting as a collective unit.

<sup>68</sup> 5 U.S.C. App. 2 § 10(c).

<sup>69</sup> *Id.* § 10(b); *see also* 5 U.S.C. § 552.

<sup>70</sup> 5 U.S.C. App. 2 § 14. An exception may be made pursuant to legislation or a renewal by the establishing entity.



# Antideficiency Act

The Antideficiency Act (“ADA”) is a series of provisions incorporated into appropriation laws since the 1870s. It prohibits federal agencies from spending public funds without permission from Congress and from accepting voluntary goods or services.<sup>71</sup> The broad scope of the ADA, however, means that agency staff are wary of even minimal contributions of freely given information regarding technical innovations to an agency.

## Regulatory Concerns

Agency staff have identified the following potential barriers to innovation resulting from the ADA’s requirements:

- An agency staffer stated that companies, foundations, and regulated entities often want to provide information — briefings, studies, memoranda, raw research data, etc. — without charge to regulators writing rules or guidance. However, this information has value in the market, as it requires time, money, and manpower to conduct this research and compile it into a usable format. Innovation staff have been told that accepting such information would violate the ADA’s prohibition on receiving voluntary goods and services.
- In one instance, an agency staffer stated that a company wanted to provide its regulator with free access to an online resource for evaluation purposes. The regulator was informed that mere access to this resource constituted a thing of value, and thus the ADA prohibited the regulator from evaluating the resource.
- In another instance, an agency considered asking a professor who had recently published a paper on a topic of interest to the agency to meet with members of the agency’s staff and discuss this research at the agency’s headquarters. Although the professor was willing to have this discussion for free (and in practice, professors often speak for free in a number of

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<sup>71</sup> U.S. Gov’t Accountability Office, Antideficiency Act Resources, <https://www.gao.gov/legal/appropriations-law-decisions/resources>.

venues), the agency concluded that doing so would constitute accepting voluntary services, and therefore the speech would have violated the ADA.

- More broadly, several agency staffers cited the Antideficiency Act — coupled with the Federal Acquisition Regulations (as discussed below) — as an impediment to conducting pilot testing of new regulatory technologies, which some regulators see as essential to remain at the forefront of technological development. At least one regulator noted that parallel entities, such as the Bank of England’s Fintech Accelerator, are able to implement pilot programs that seem untenable under the current U.S. regulatory structure.
- Although not a substantive limitation, Congress has attached significant penalties to ADA violations. Federal government employees may face employment repercussions and criminal penalties for otherwise acceptable activities that happen to violate the ADA. Agency staff cited these penalties as a significant deterrent — both for themselves and for federal agencies as a whole — in taking any actions that may run afoul of the ADA.

## Application and Impact of the ADA

The ADA was enacted to reinforce, and serves as one of the major vehicles for Congress’s “power of the purse” — that is, Congress’s exclusive authority to authorize any government spending of public funds under Article 1, Section 9 of the Constitution: “No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law[.]”<sup>72</sup> Challenges to Congress’s spending authority, particularly by federal agencies “incurring ‘coercive’ deficiencies and thereby circumventing amount limitations in appropriations legislation,” were a chronic problem for Congress in the 19th century.<sup>73</sup> The term “coercive deficiency” describes deficiencies in funding that result from agencies or government officials receiving services that Congress has not yet approved funds for, with the intention of imposing a moral obligation on Congress to pay for them. Agencies used this practice in the early 1800s to bypass Congress’s spending authority. The ADA safeguards Congress’s spending power in instances of disagreement between branches on spending policy.<sup>74</sup>

In 1905 and 1906, Congress “sought to strengthen” the 1870 law by adding restrictions on voluntary services provided to the government, by imposing criminal punishments for violators, and by mandating that appropriations be apportioned in installments instead of all at once.<sup>75</sup> The authority to waive these requirements that some agency heads initially had was pared back,

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<sup>72</sup> U.S. Const. art. I, § 9, cl. 7.

<sup>73</sup> Kate Stith, *Congress’ Power of the Purse*, 79 Yale L.J. 1343, 1370 (1988) (emphasis added).

<sup>74</sup> Outside of the innovation concerns raised in this paper, the Antideficiency Act is generally known as the law that leads to government shutdowns in the event that a budget is not signed into law. Prior to the early 1980s, agencies would continue to function during these gaps in funding, while attempting to cut nonessential services, and Congress would pay the bill later. However, then-Attorney General Benjamin Civiletti issued two opinions in the early 1980s instructing federal agencies to halt all activities, except those deemed essential by law, during the funding gaps. Jared C. Nagel & Justin Murray, Cong. Research Serv., R41759, Past Government Shutdowns: Key Resources 3 (2019).

<sup>75</sup> Clinton T. Brass, Cong. Research Serv., RL30795, General Management Laws: A Compendium, at 93 (2004).



culminating in a 1933 executive order transferring the waiver authority to the Director of the Bureau of the Budget (the predecessor of the Office of Management and Budget).<sup>76</sup>

Today, the ADA imposes several limitations on the actions of government employees:

- Making or authorizing an expenditure from, or creating or authorizing an obligation under, any appropriation or fund in excess of the amount available in the appropriation of fund unless authorized by law.<sup>77</sup>
- Involving the government in any contract or other obligation for the payment of money for any purpose in advance of appropriations made for such purpose, unless the contract or obligation is authorized by law.<sup>78</sup>
- Accepting voluntary services for the United States, or employing personal services not authorized by law, except in cases of emergency involving the safety of human life or the protection of property.<sup>79</sup>
- Making obligations or expenditures in excess of an apportionment or reappropriation, or in excess of the amount permitted by agency regulations.<sup>80</sup>

Despite these statutory limitations, both case law and agency interpretation have created limited exceptions to the otherwise strict requirements of the ADA. According to the GAO, the Comptroller of the Treasury, the Justice Department, and the GAO itself “continue to follow to this day” a distinction that the then-Attorney General drew in 1913:

[I]t seems plain that the words ‘voluntary service’ were not intended to be synonymous with ‘gratuitous service’ and were not intended to cover services rendered in an official capacity under regular appointment to an office otherwise permitted by law to be non-salaried. In their ordinary and normal meaning, these words refer to service intruded by a private person as a ‘volunteer’ and not rendered pursuant to any prior contract or obligation . . . . It would be stretching the language a good deal to extend it so far as to prohibit *official* services without compensation in those instances in which Congress has not required even a minimum salary for the office.<sup>81</sup>

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<sup>76</sup> Exec. Order No. 6,166, Organization of Executive Agencies (June 10, 1933), <https://www.archives.gov/federal-register/codification/executive-order/06166.html>.

<sup>77</sup> 31 U.S.C. § 1341(a)(1)(A). We note that the “unless authorized by law” language in this section and the “cases of emergency involving the safety of human life or the protection of property” language below are generally considered to be the basis for requiring certain critical employees to work without pay during a federal government shutdown.

<sup>78</sup> 31 U.S.C. § 1341(a)(1)(B).

<sup>79</sup> *Id.* § 1342.

<sup>80</sup> *Id.* § 1517(a).

<sup>81</sup> U.S. Gov’t Accountability Office, GAO-06-382SP, Principles of Federal Appropriations Law, at 96 (2006) (alteration in original) (quoting Emp’t of Retired Army Officer as Superintendent of Indian Sch., 30 Op. Att’y Gen. 51 (1913)).

Nearly a century later, the deputy assistant attorney general of the United States issued a memorandum<sup>82</sup> distinguishing between prohibited voluntary services and “gratuitous services” that the government can accept. Similarly, the GAO asserts that the Comptroller of the Treasury agreed with the following interpretation of the voluntary services provision:

[The ADA] was intended to guard against claims for compensation. A service offered clearly and distinctly as gratuitous with a proper record made of that fact does not violate this statute against acceptance of voluntary service. An appointment to serve without compensation which is accepted and properly recorded is not a violation of [31 U.S.C. § 1342], and is valid if otherwise lawful.<sup>83</sup>

Furthermore, according to a decision rendered by the GAO in 2014, “[a]n agency may accept unpaid services when someone offering such services executes an advance written agreement that (1) states that the services are offered without expectation of payment, and (2) expressly waives any future pay claims against the government.”<sup>84</sup>

## **Addressing the ADA’s Barriers to Regulatory Innovation**

There are several potential avenues to address the real limitations the ADA imposes upon innovation. As the ADA is a federal law, Congress could draft a regulatory innovation exception for information gathered for the limited purposes of evaluation and analysis in rulewriting. Such an exception would have the benefit of being permanent and would also provide clear and definitive protection to individual federal employees who are dissuaded from accepting such information by the ADA’s potential for administrative and criminal penalties.

Alternatively, the GAO and Justice Department guidance regarding “gratuitous” services may be relied upon with greater frequency. From our discussions with agency innovation staff, the goal of industry and agencies is to get the right information into the hands of agency leadership, not to burden the government with a legal or moral obligation to pay for this information. As such, this seems to fit within the purpose of the “gratuitous” service exception that has existed for more than a century. Agency innovation staff — working with agency general counsel — can develop more clarity and guidance around this exception and find ways to use it to spur growth in innovation.

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<sup>82</sup> Mem. Op. for the Deputy Counsel to the President, The White House Office—Acceptance of Voluntary Serv. (31 U.S.C. § 665(b)), 2 Op. O.L.C. 322, 322 (1977), <https://www.justice.gov/file/21296/download>.

<sup>83</sup> U.S. Gov’t Accountability Office, GAO-06-382SP, Principles of Federal Appropriations Law 97 (2006) (second alteration in original) (quoting 27 Comp. Dec. 131 (1920)).

<sup>84</sup> Dep’t of the Treasury, Comp. Gen., B-324214, 2014 WL 293545, at \*3 (Jan. 27, 2014).



# Federal Acquisition Regulation

The Federal Acquisition Regulation (“FAR”)<sup>85</sup> implements the Federal Acquisition Regulation System, which was “established for the codification and publication of uniform policies and procedures for acquisition by all executive agencies.”<sup>86</sup> At a general level, FAR establishes a set of policies, procedures, and standards for federal agencies to acquire goods and services from the private sector that is intended to provide the best value to the government while being transparent, fair, and competitive.<sup>87</sup> In addition to overarching rules, the procurement regulations provide supplements to FAR for specific agencies, including the Department of Defense Federal Acquisitions Regulations System (“DFARS”) and the Department of the Treasury Acquisition Regulations System (“DTARS”).

FAR generally applies to all executive agencies, with some exceptions (*e.g.*, grants, cooperative agreements, purchases, or leases of real property).<sup>88</sup> Further, FAR applies when an agency engages in an “acquisition” or the “acquiring by contract with appropriated funds of supplies and services.”<sup>89</sup> “Executive agency” includes executive departments, military departments, independent establishments of the executive branch, and “wholly owned Government corporation[s].”<sup>90</sup>

## Regulatory Concern

Agency staff expressed concerns about the lack of flexibility in FAR acquisition requirements, especially for smaller contracts or procurements. While some smaller acquisitions can be done through an abbreviated process, staff indicated that the FAR exemption thresholds are too low to

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<sup>85</sup> 48 C.F.R. §§ 1.000–53.300.

<sup>86</sup> *Id.* § 1.101.

<sup>87</sup> *Id.* § 1.102.

<sup>88</sup> See Kate M. Manuel et al., Cong. Research Serv., R42826, *The Federal Acquisition Regulation (FAR): Answers to Frequently Asked Questions* 5 n.22 (2015) (citing 31 U.S.C. §§ 6303–6305); 48 C.F.R. § 2.101(b) (noting the definition of “supplies” does not include land and interests in land).

<sup>89</sup> 48 C.F.R. § 2.101(b)(2); Federal Acquisition Regulation (FAR), U.S. Gen. Servs. Admin, <https://www.gsa.gov/policy-regulations/regulations/federal-acquisition-regulation-far> (follow “Federal Acquisition Regulation (FAR)” hyperlink) (last updated Feb. 26, 2019) (hereinafter, FAR).

<sup>90</sup> 48 C.F.R. § 2.101(b); 5 U.S.C. §§ 101, 102, 104(1). We note, however, that several federal financial agencies are funded through sources other than congressional appropriations and therefore are not subject to the FAR.

be of much use in the financial innovation space. Similarly, one agency staffer noted that there is not much opportunity to deviate from FAR for unique procurements that do not readily fit into its larger acquisition model, such as fintech and regtech contracts.

Several agency staff members noted that there is a concern around procuring regtech software or products because doing so could be seen as an endorsement of a particular product or service. The market may misinterpret — or a company may outwardly market — a contract signed purely for evaluation purposes as demonstrating some sort of tacit government acceptance of a product.

Agency staff also noted the challenges with evaluating fintech products with a small or limited acquisition, as these products tend to require scale to be effective (*e.g.*, machine learning or artificial intelligence programs that requires a minimum threshold of data to perform analysis). Without acquiring both the fintech product and a sufficient body of test data — assuming that test data is even available for purchase — it is difficult for a regulator to meaningfully evaluate the product.

## Application and Impact of FAR

FAR requires executive agencies to proceed through an established process to acquire goods or services. At a high level, any acquisition proceeding through FAR process requires:

- Establishing an organizational or agency need for the procurement through a capability development process, considering costs, benefits, and an analysis of alternatives.<sup>91</sup>
- Defining contract requirements and developing an acquisition strategy, which includes developing contract language and evaluation criteria through a request for proposals.<sup>92</sup>
- Evaluating vendor proposals, resolving clarification and deficiencies, and awarding contracts to a particular vendor based on established standards.<sup>93</sup>
- Reporting suspected antitrust violations based on a review of vendor bids or proposals.<sup>94</sup>
- Prohibiting most forms of gifts or gratuities, including contingent fees, kickbacks for federal employees, and any conflict of interest issues that may arise.<sup>95</sup>
- Imposing certain prohibitions against selection officials seeking or obtaining employment post-award.<sup>96</sup>

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<sup>91</sup> *E.g.*, 48 C.F.R. § 7.102.

<sup>92</sup> *E.g.*, *id.* §§ 7.104, 7.105.

<sup>93</sup> *E.g.*, *id.* §§ 6.102, 7.105.

<sup>94</sup> *E.g.*, *id.* § 3.303.

<sup>95</sup> *E.g.*, *id.* §§ 3.202, 3.402, 3.502-2.

<sup>96</sup> *E.g.*, *id.* § 3.104-6.

- Prohibiting disclosure of source selection materials (vendor bids or proposals).<sup>97</sup>

Agencies may establish and implement their own FAR requirements so long as they “implement or supplement the FAR and incorporate, together with the FAR, agency policies, procedures, contract clauses, solicitation provisions, and forms that govern the contracting process or otherwise control the relationship between the agency, including any of its suborganizations, and contractors or prospective contractors.”<sup>98</sup> For instance, the DTARS sets forth additional requirements regarding the qualification of contractors and prescribes certain necessary elements of an acquisition strategy for major systems.<sup>99</sup>

FAR does have some flexibility to enable executive agencies to acquire essential goods and services without strict adherence to its requirements, typically for the “development and testing of new techniques and acquisition methods.”<sup>100</sup> An agency head is generally authorized to allow “[i]ndividual deviations,” which are deviations from FAR “affect[ing] only one contract action,” so long as the contracting officer “document[s] the justification and agency approval in the contract file.”<sup>101</sup>

Congress has the authority to exempt particular purchases of goods or services by an agency from FAR requirements.<sup>102</sup> For example, Congress directed the National Oceanic and Atmospheric Administration (“NOAA”) to “enter multiyear contracts for oceanographic research, fisheries research, and mapping and charting services to assist in fulfilling NOAA missions ‘[n]otwithstanding any other provision of law.’”<sup>103</sup> Congress’s decision to use the phrase “[n]otwithstanding any other provision of law” in enacting this statute was held to exempt this purchase from FAR’s requirements.<sup>104</sup>

Finally, some agencies, such as the Department of Defense, have other transaction authorities (“OTAs”) that allow them to procure goods and services for research, development, and prototyping purposes outside of FAR’s requirements.<sup>105</sup> The use of OTAs can only occur when certain criteria are met — for instance, when “at least one-third of the total cost of the prototype project is provided by nongovernmental participants[.]”<sup>106</sup> OTAs can provide rapid access to emerging and cutting edge technology in a manner faster than traditional FAR acquisitions;

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<sup>97</sup> *E.g., id.* §§ 3.104-3, 3.104-4.

<sup>98</sup> *Id.* § 1.301(a).

<sup>99</sup> *See id.* § 1034.004.

<sup>100</sup> *Id.* § 1.402.

<sup>101</sup> *Id.* § 1.403. Note that “class deviations” or deviations that would “affect more than one contract action” generally require at least a consultation with the chairperson of the Civilian Agency Acquisition Council, “unless that agency official determines the urgency precludes such consultation.” *Id.* § 1.404(a).

<sup>102</sup> *See* Kate M. Manuel et al., Cong. Research Serv., R42826, The Federal Acquisition Regulation (FAR): Answers to Frequently Asked Questions, at 3, 5 n.25 (2015) (quoting 33 U.S.C § 891d(b)).

<sup>103</sup> *Id.* at 5 n.25.

<sup>104</sup> *Id.*

<sup>105</sup> 10 U.S.C. §§ 2371, 2371b.

<sup>106</sup> Heidi M. Peters, Cong. Research Serv., R45521, Department of Defense Use of Other Transaction Authority: Background, Analysis, and Issues for Congress, at 2 (2019).

however, some critics claim that OTA authority can result in a lack of transparency and abuse.<sup>107</sup> Nevertheless, OTAs remain a viable way for certain agencies (and their partner agencies) to rapidly acquire, develop, and test new technologies and prototypes.

## **Addressing FAR's Barriers to Regulatory Innovation**

FAR is product of the APA's notice-and-comment process.<sup>108</sup> Thus, the issues identified above in the discussion of the APA would apply to any attempt to revise the FAR.

Absent an administrative revision to FAR, agencies that want to engage in transactions more quickly than FAR allows may consider partnering with other agencies that rely on OTAs to procure goods and services for research, development, and prototyping purposes. Further, as a practical rule, only certain agencies have OTAs, and their goals may not align with those of an innovation leader looking to test a new product or service.

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<sup>107</sup> *Id.* at 6–9.

<sup>108</sup> *See* Kate M. Manuel et al., Cong. Research Serv., R42826, The Federal Acquisition Regulation (FAR): Answers to Frequently Asked Questions, at 11 (2015) (citing 5 U.S.C. § 553).



## Personnel and Hiring Policies

A regulator's hiring and staffing decisions can have a significant impact on the way it determines what projects to pursue, which priorities it highlights, and whether innovation is compatible with its overarching mission. The laws governing federal employment are nuanced and comprehensive, and significant resources are dedicated at each agency to ensure compliance with these requirements. Even with these resources, filling a position is often a lengthy proposition, and the process itself can create confusion regarding employment preferences, applicant qualifications, and position availability. And after hiring, personnel policies can discourage individual employees from exploring new areas and agencies from offering support for them to do so.

### Regulatory Concerns

Agency staff identified the following potential barriers to innovation resulting from agency hiring and staffing policies:

- One agency staffer felt there were too few employees in the agency with the desire or expertise to focus on improving innovation. In this individual's view, strict hiring requirements make it difficult to recruit people with the right technological experience and other skills that support innovative work.
- Another agency staff member said that even when the agency had employees with the right aptitude for innovation, they faced challenges in putting their skills to use because they were not located within a group that permitted them to have an impact on regulatory innovation. Because new technologies can raise both legal and cross-divisional issues, it may make sense to house an agency's innovation initiatives in a separate group with a horizontal focus, such as under the general counsel's office.
- Some agency staff with whom we spoke suggested the use of temporary federal government rotations for individuals who are otherwise employed in private industry. While rotations are used within and across federal government agencies, these individuals suggested expanding rotations to include private sector employees who may be able to bring unique skills and experiences to the mission of federal agencies focused on fintech issues.

- While the agency staff with whom we spoke understood that hiring and staffing requirements accomplish important tasks and help to protect against favoritism and abuse of public funds, they nevertheless questioned whether the priorities in the hiring process are sufficiently aligned with the need to hire and support talented individuals focused on regulatory innovation.

## Impact of Agency Hiring and Staffing Laws

Federal hiring laws and regulations establish the procedures and standards by which federal agencies hire and retain human capital in a manner that is competitive and in accordance with “merit system principles.”<sup>109</sup> Merit system principles include concepts such as (1) “fair and open competition” from all “segments of society”; (2) “fair and equitable treatment” free of discrimination from “race, color, religion, national origin, sex, marital status, age, or handicapping condition”; (3) equal pay for work of equal value; (4) “high standards of integrity, conduct, and concern for the public interest”; (5) efficiency and effectiveness; and (6) adequate training and education.<sup>110</sup> Federal employment laws generally apply to all executive agencies, encompassing “an Executive department, a Government corporation, and an independent establishment.”<sup>111</sup>

The majority of nonpolitical positions are within the “competitive service,” which requires agencies to follow rigorous Office of Personnel Management (“OPM”) rules governing announcements, examinations, certifications, and appointments before hiring a federal employee.<sup>112</sup> Federal employees with “competitive status” can generally obtain another competitive position in the federal government without going through the general appointment procedures.<sup>113</sup>

OPM has effectively been relegated to a supportive function for competitive service positions because the OPM director may delegate “in whole or in part, any function vested in or delegated to the Director, including authority for competitive examinations” to agency heads.<sup>114</sup> Most executive agencies are delegated examining units that have the authority to conduct their own competitive hiring.<sup>115</sup> Each agency has supplemented OPM with its own independent policies and procedures designed to make hiring more efficient than through a centralized employment function.<sup>116</sup>

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<sup>109</sup> 5 U.S.C. § 2301(b).

<sup>110</sup> *Id.*

<sup>111</sup> *Id.* §§ 105, 2301(a)

<sup>112</sup> *See generally* 5 C.F.R. §§ 3301 *et seq.*

<sup>113</sup> *Id.* § 212.301.

<sup>114</sup> 5 U.S.C. § 1104(a)(2).

<sup>115</sup> Ben L. Erderich et al., *The Role of Delegated Examining Units: Hiring New Employees in a Decentralized Civil Service*, Merit Sys. Protection Board, at 1–2 (1999),

<https://www.mspb.gov/MSPBSEARCH/viewdocs.aspx?docnumber=253645&version=253932&application=ACROBAT>.

<sup>116</sup> *Id.* at 1–4.



In addition to delegated hiring authority, executive agencies also retain several other hiring authorities, including “direct-hire authority”<sup>117</sup> and excepted service authority,<sup>118</sup> which are generally exempt from the requirements of competitive service hiring. Excepted positions are usually those defined as of a “policy-determining”<sup>119</sup> nature or those that “involve a close and confidential” relationship with the “head of an agency or other key appointed officials.”<sup>120</sup> These include, among others, federal attorneys, law clerk trainee positions, and temporary science and technology positions.<sup>121</sup> Because excepted service positions are generally not required to follow all aspects of competitive service hiring, candidates selected for these positions generally are not granted competitive service status.<sup>122</sup> With the exception of veterans’ preferences<sup>123</sup> and certain disqualifying requirements,<sup>124</sup> hiring procedures and qualifications for excepted positions are generally delegated to agency heads.<sup>125</sup>

The complexity of federal employment laws has in many cases caused long delays between job posting and job offer. This, and the overall complexity of federal hiring requirements, can dissuade applicants from applying for government jobs and create frustration for those who do apply. And once hired, it can be difficult for employees to move to different groups or units. In some instances, an internal move may require an additional application for a competitive position; in other instances, budget limitations within different divisions may prevent placing an employee in a new position that better matches his or her talents. These complications can limit an agency’s ability to put its workforce to its best use in encouraging regulatory innovation.

## **Addressing Barriers to Regulatory Innovation Posed by Agency Hiring and Staffing**

The challenges to innovation arising from federal agencies’ hiring policies are a product of both congressional legislation as well as internal decisions by OMB and the individual agencies engaged in hiring. Although Congress has the authority to resolve these issues through legislation addressing federal hiring policy, individual agencies may also want to examine their own hiring policies — in particular, the use of direct-hire authority and excepted service authority — to identify ways to hire and place innovation-focused employees in positions where they can offer the most valuable service. Although it often functions in a support role to agencies, OMB may be able to assist by providing a centralized repository of policies, procedures, guidelines, and best

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<sup>117</sup> 5 C.F.R. § 337.201.

<sup>118</sup> 5 U.S.C. § 2103.

<sup>119</sup> 5 C.F.R. §§ 213.3101; 213.3201.

<sup>120</sup> *Id.* §§ 213.3301, 213.3401.

<sup>121</sup> *Id.* § 213.3102(d)–(e), (l), (aa).

<sup>122</sup> 5 U.S.C. § 2103.

<sup>123</sup> 5 C.F.R. § 301.201.

<sup>124</sup> *Id.* § 301.203.

<sup>125</sup> *Id.* § 301.102.

practices related to hiring personnel capable of promoting innovation. In so doing, OMB can give agencies the tools they need to staff in a forward-looking, pro-innovation manner.



## Agency Culture

While laws and internal procedures govern how agencies are permitted to operate, these mandates are interpreted, applied, and shaped by the individuals who lead and staff the agencies themselves. Leaders have a profound influence on agency operations and priorities and are the cornerstone of the loosely defined — yet incredibly important — concept of agency culture. An agency culture that prioritizes and pursues regulatory innovation can jumpstart change. By contrast, a culture of risk aversion and “siloeing” employees can be a barrier to innovation, even in the presence of external motivators like Congress and industry heavyweights. The agency staff interviewed for this paper expressed a keen awareness of the influence of agency culture on regulatory innovation and identified a number of areas where changes to agency culture could have profound effects on the resources that agencies direct towards supporting innovation in the marketplace.

### Regulatory Concerns

Agency staff members said culture represented one of the most critical and deeply rooted impediments to the development and implementation of regulatory innovation and support for technology:

- One agency staffer said long-term agency employees often prioritize deep expertise in a particular discipline over lifelong learning that can morph into gaining experience in new topics. While this individual acknowledged that subject-matter experts are a necessary and valuable part of any agency, the individual saw the need for a broader skill set that includes flexibility as government and industry priorities shift. This staff member was also concerned that the narrow silos of expertise at agencies could prevent employees from making connections with other experts in different but complementary areas.
- Another agency staffer echoed similar concerns about subject-matter expertise, and in particular noted that, for legacy systems that have since expired, there may only be one person with all of the institutional knowledge and training — resulting in that person being in a position to exert a disproportionate amount of influence.
- One agency staff member noted the supervision culture presents a particularly difficult challenge, as examiners are lauded for uncovering and identifying problems at regulated

institutions, because doing so supports the agency’s mission of identifying and preventing violations of law. Agencies, however, are also charged with encouraging economic growth, but this individual did not see the same energy or interest directed toward finding ways to responsibly solve regulatory impediments or work to grow opportunities for new products and innovation in the market.

- Another agency staffer said agency supervisory culture does not provide the same encouragement for examiners to work with supervised institutions to encourage innovation of new financial products. According to this agency innovation staffer, there is more cultural support for saying “no” to a new product or service than saying “yes.”
- Agency staff also indicated agencies’ lack of emphasis on technological literacy and experimentation, as well as limited coordination across agencies with similar mandates but differing jurisdictions. This individual posited that further focus on these areas would help the agencies develop a culture that encourages them to promote innovations both within and outside of the agency.

## Impact of Agency Culture

Unlike the statutory paradigms outlined above, agency culture is a loosely defined concept that is not governed by a particular law and manifests differently within each individual agency. Nevertheless, culture is critical to an agency’s ability to move from idea generation to implementation. Concerns about congressional and media scrutiny, inconsistency with other regulators’ innovation efforts, and internal policies and promotion opportunities can all affect agency culture. Over time, a culture of risk aversion, even when intended to reflect accountability, can result in meaningful disincentives to agency innovation.<sup>126</sup> A recent statement by the executive director of the Defense Innovation Board highlights this issue:

Whereas if the Defense Innovation Unit wants to do something iterative and experimental at speed and buy down the risk of a failure and fail small and inexpensively quickly, that’s held for maximum accountability, you have hearings for that. . . . We said it’s [ok] to fail, you just have to fail very slowly, you have to fail very expensively and you have to fail with a high degree of documentation.<sup>127</sup>

Although this paper separates federal hiring and staffing policies from agency culture, the two are inextricably linked, and increasing instability in the federal workforce can limit a culture of innovation. Continuing resolutions and government shutdowns have reduced stability in the

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<sup>126</sup> For example, a former Air Force general noted that “Congress’ emphasis on accountability in its oversight of Pentagon acquisitions has been well-intentioned, but it’s also created a disincentive for taking risks.” Joe Gould, *How the Pentagon’s Fear of Risk is Stifling Innovation*, Def. News (Jan. 28, 2019), <https://www.defensenews.com/congress/2019/01/28/is-the-pentagons-fear-of-risk-stifling-innovation/>.

<sup>127</sup> *Id.*

federal workforce and have had a pronounced effect on the morale of the federal workforce within the last decade.<sup>128</sup> Recent studies also show that the pay scales for competitive service workers on the general schedule, which is governed by federal law, can stifle retention and recruiting efforts<sup>129</sup> with direct and indirect negative impacts on a willingness and ability to innovate. Finally, changes in administrations can have a positive or negative effect on turnover and federal culture.<sup>130</sup>

The GAO has also identified agency culture as a key consideration when determining whether innovative initiatives involving external (*i.e.*, nongovernment) actors are likely to be successful. For example, the GAO has found that agencies “should consider whether their staff has sufficient time and expertise to design and implement a strategy” and must assess whether they have “[t]he support and approval of agency leaders for the potential use of an open innovation strategy . . . .”<sup>131</sup> In particular, the GAO highlighted that leadership buy-in for innovative outreach “can be particularly important, as their involvement can lend credibility and visibility to an initiative to those outside the agency. It can also help mobilize a broader community of external stakeholders and partner organizations.”<sup>132</sup>

Finally, agency culture has been affected by structural issues that limit the implementation of flexible work arrangements, such as teleworking, developmental and rotational assignments, and cross-training. The absence of these benefits — which private industry is quickly adopting — has been shown to have a negative effect on federal recruiting and retention and can chill efforts to create a forward-thinking culture.<sup>133</sup> Certainly, some of these issues are unavoidable. For instance, if a particular job skill requires the use of a lab or consistent access to classified or confidential information, telework may not be possible. However, agency innovation staff noted that in many cases these limitations arise not from pragmatism, but rather from a larger cultural resistance to change.

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<sup>128</sup> See Chloe Reichel, *The Short- and Long-Term Effects of a U.S. Government Shutdown*, Journalist’s Resource (Jan. 17, 2019), <https://journalistsresource.org/studies/government/budget/government-shutdown-effects-research/> (assessing the negative effects on the federal workers as a result of shutdowns); see also Gretchen Frazee, *The Government’s Workforce is Aging. Now the Shutdown Could Make Hiring Harder*, PBS (Jan. 18, 2019), <https://www.pbs.org/newshour/economy/making-sense/the-governments-workforce-is-aging-now-the-shutdown-could-make-hiring-harder> (discussing ongoing retention, hiring, and morale issues within the federal workforce as a result of continuous shutdowns).

<sup>129</sup> Accenture, *Recruiting and Retaining Talent in the Public Sector: The Differences that Make the Difference*, at 3 (2015), [https://www.accenture.com/t20170411T142500Z\\_w\\_/in-en/\\_acnmedia/Accenture/Conversion-Assets/DotCom/Documents/Global/PDF/Dualpub\\_20/Accenture-804116-Talent-Retention-Pulse-Survey-V06-LR-NO-CROPS.pdf](https://www.accenture.com/t20170411T142500Z_w_/in-en/_acnmedia/Accenture/Conversion-Assets/DotCom/Documents/Global/PDF/Dualpub_20/Accenture-804116-Talent-Retention-Pulse-Survey-V06-LR-NO-CROPS.pdf) (hereinafter Accenture Paper) (noting that 60 percent of citizens identify “regular compensation increases” as important).

<sup>130</sup> See, e.g., Michael Wald, *Turnover Up as More Workers Quit the Federal Government*, FedSmith (Mar. 22, 2018), <https://www.fedsmith.com/2018/03/22/turnover-workers-quit-federal-government/> (reporting a 16.7 percent turnover rate in 2017, post-election, and a 5.6 percent layoff and discharge rate).

<sup>131</sup> U.S. Gov’t Accountability Office, GAO-17-14, *Open Innovation: Practices to Engage Citizens and Effectively Implement Federal Initiatives*, at 14 (2016).

<sup>132</sup> *Id.* at 25.

<sup>133</sup> See Accenture Paper, *supra* note 129.

## **Addressing Barriers to Regulatory Innovation Posed by Agency Culture**

There is no one law or regulation responsible for an individual agency's culture; rather, it is a product of overall legal, political, personnel, and public policy forces that operate within and from outside an agency. Changing the culture of an agency that has developed over decades poses an even greater challenge. Motivating employees to accept changes that could be viewed as threatening their seniority, subject-matter expertise, job security, or pace of work is difficult, particularly where there may not be resources or statutory authority for financial or other incentives to compensate employees for accepting these changes. Because each agency's culture is unique, the agencies themselves are in the best position to develop and implement long-term strategies designed to change a "battleship" culture into something that can move more deliberately and with greater agility and speed. As observed in the GAO report mentioned above, this will require the unequivocal support of agency leadership and may even benefit from interagency coordination to show a shared commitment to prioritizing innovation within the executive branch.



## Conclusion

In highly regulated industries like financial services, innovation that does not pass regulatory muster isn't innovation at all. Providers depend upon regulatory approval to bring new ideas and methods to the marketplace. Balky or inefficient regulation can significantly dampen the development of new products and services, resulting in a loss of opportunities for American consumers and a serious structural competitive disadvantage for US-based financial services firms.

Financial regulatory staff who are responsible for facilitating industry innovation have supplied the information and views we relied upon to identify administrative hurdles that they believe hold back innovation. Many of the longstanding policies and practices that created these hurdles may have had a good purpose when they came into existence but now appear to have unintended and detrimental effects. The aim of this paper, which we undertook at the request of the Omidyar Network, is to provide a summary of administrative practices and regulations identified by regulators as presenting hurdles or barriers to financial innovation.

As technology reshapes the creation and delivery of financial products and services and accelerates the pace at which they change, remaining at the forefront of innovation is an economic priority for our country. The regulatory-administrative process is moving forward at a linear pace but technology is advancing exponentially, and regulators are finding themselves falling behind in their ability to anticipate and address change. Promoting an environment in which those charged with regulating the financial services industry have the tools to facilitate and evaluate the use of technology is essential to permitting our national financial services sector to compete in the digital age.

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