December 31, 2017

Alexis Podesta, Secretary
California Business, Consumer Services and Housing Agency
915 Capitol Mall, Suite 350-A
Sacramento, CA 95814

Dear Ms. Podesta,

In accordance with the State Leadership Accountability Act (SLAA), the Department of Business Oversight (DBO) submits this report on the review of our internal control and monitoring systems for the biennial period ending December 31, 2017.

Should you have any questions please contact Lisa Crowe, DBO Chief Deputy Commissioner, at 916-324-6623, lisa.crowe@dbo.ca.gov.

BACKGROUND

The DBO serves as the state's primary regulator of financial services, products and professionals, and provides protection to consumers and services to businesses engaged in financial service transactions. At the end of 2017, the DBO maintained oversight of 23 financial service industries, and licensed and supervised more than 360,000 individuals and businesses. Its regulatory purview extends over domestic and foreign banks, industrial banks, credit unions, payday lenders, mortgage lenders, originators and servicers, finance lenders, escrow companies, broker-dealers and investment advisers, money transmitters (Western Union, PayPal and others), as well as premium finance companies, student loan servicers, business and industrial development corporations, check sellers and trust companies. The DBO has two primary regulatory responsibilities: protect consumers and protect the health of financial service markets.

The DBO's regulatory authority and its licensees are governed by the California Financial Code and Corporations Code. The DBO's FY 2017-18 budget totaled $91.1 million and authorized 641 positions. The DBO is funded entirely with special funds derived mainly from fees paid by licensees. The DBO was formed July 1, 2013 pursuant to the Governor's Reorganization Plan No. 2 (GRP 2) with the consolidation of the Department of Corporations (DOC) and the Department of Financial Institutions (DFI).

Mission:

Serve Californians by effectively overseeing financial service providers, enforcing laws and regulations, promoting fair and honest business practices, enhancing consumer awareness, and protecting consumers by preventing potential marketplace risks, fraud and abuse.

Goals:

1. Be a leading financial services regulator protecting consumers and supporting financial security.
2. Maximize resources effectively and efficiently in support of the Department's mission.
3. Build an exceptional organization with outstanding leadership and a highly engaged, collaborative workforce.
4. Increase efficiency and effectiveness through innovative use of technology and education.

Core Values:

1. Collaboration – We work as a team to foster a culture of learning, respect, and open communication to effectively solve problems and accomplish goals.
2. Integrity – We are fair, honest, and accountable.
3. Service – We are dedicated to providing exceptional support to the public and licensees.
4. Vigilance – We are diligent in executing our responsibilities.

Strategic Initiatives:

- Customer Service – Secure the confidence of consumers, licensees and the public, and help consumers make more informed decisions in the financial services market. By 2019, complaints filed with DBO will meet processing standards.
- Public Relations – Make DBO the number one name in financial services regulation for consumers, the public and media.
- Increase productivity by 10% (as measured by workload) through process analysis.
- Increase employee retention by 10% within three years based on retention information from HR.
- More than 50 percent of managers are eligible for retirement. In order to prepare staff to assume leadership positions, 90% of staff will complete an approved leadership development or team building classes in next five years.
- By 2020, 100% of all Department files will be scanned, stored, and accessible from a central divisional repository.

ONGOING MONITORING

As the head of DBO, Jan Lynn Owen, Commissioner, is responsible for the overall establishment and maintenance of the internal control and monitoring systems.

Executive Monitoring Sponsor(s)

The executive monitoring sponsor responsibilities include facilitating and verifying that the DBO internal control monitoring practices are implemented and functioning as intended. The responsibilities as the executive monitoring sponsor(s) have been given to: Lisa Crowe-Chief Deputy Commissioner, Scott Cameron-Senior Deputy Commissioner, Division of Financial Institutions, Edgar Gill-Senior Deputy Commissioner, Division of Corporations, and Scott Wyckoff-General Counsel.

Monitoring Activities

All levels of DBO management and personnel are responsible for ensuring that adequate internal controls are in place within their respective program areas. DBO continually evaluates internal control systems to ensure that risks are adequately addressed. Experts in each program area discuss concerns in daily, weekly, monthly, quarterly and annual meetings and raise potential issues with supervisors for consideration. Any critical items identified are evaluated by first-line managers, middle managers, senior managers and executive leadership for mitigation. DBO's senior executives consult on the highest-level priorities to properly address issues, assign resources and monitor progress.

A risk must be documented when it meets both of the following criteria:

1. The ability of the DBO (program specific or enterprise-wide) to carry out mission-critical or mandated functions is threatened.
2. There is no known internal control (existing business process) in place to mitigate the risk.

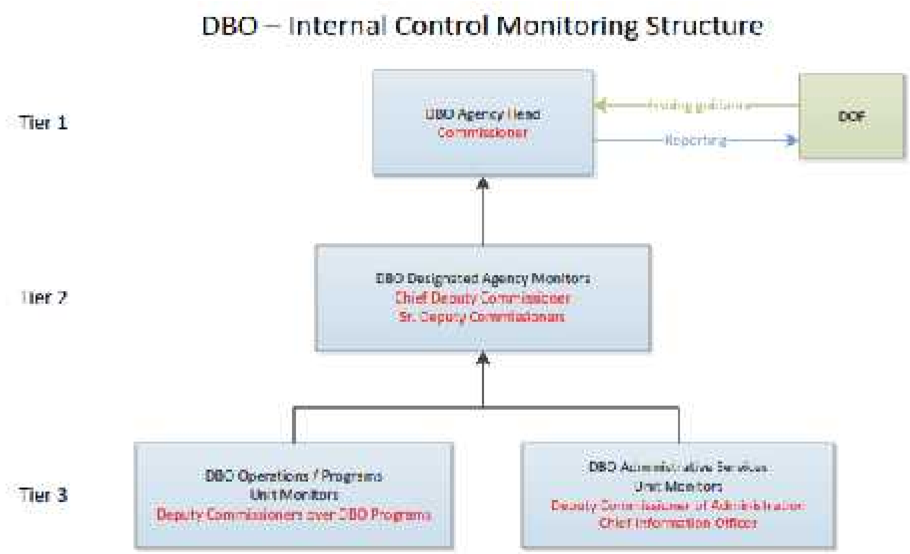
Staff members in DBO's Internal Audits unit also conduct routine, robust assessments of all departmental areas on both a scheduled and an ad hoc basis to mitigate gaps. DBO's Information Technology (IT) unit employs an Information Security Officer (ISO) who continually evaluates and addresses risks to the department's IT assets and information, as well as mitigations and contingencies.

Addressing Vulnerabilities

Once potential risks are identified, and depending on their severity and/or likelihood, each scenario is considered and elevated for resolution. Any critical or serious issues are mitigated immediately, where possible. Others are prioritized based on significance and addressed through project or contract management, process improvements, policy amendments, audit findings, budget change proposals, the system development lifecycle process, or the SLAA paradigm. Assigning responsibility to take action and address these risks is based on area of expertise, experience, sphere of influence and accountability. Staff is assigned to research risk(s) as identified and to develop a plan for managing or eliminating risk. The appropriate deputy commissioner of each area with an identified risk is responsible for ensuring that progress is made toward reducing the identified vulnerability. Risks that are considered enterprise-wide may involve additional oversight by internal auditors, IT management and/or the Information Security Officer, branch chiefs, program deputy commissioners, or senior executive management, up to and including the DBO Commissioner.

Communication

The results of monitoring activities for DBO-wide risks, including any changes made to strengthen internal controls, are documented in writing and retained by the assigned deputy commissioner(s) involved. Additionally, results of monitoring activities are documented on the DBO Risk Assessment Matrix. Results are communicated in weekly senior executive staff meetings, monthly executive committee meetings as a standing agenda item, and up or down through the established DBO chain of command.



- All levels of management are involved in assessing and strengthening internal control systems per Government Code section 13401, subdivision (b)(3).
- Agency Monitoring is performed by Chief Deputy Commissioner and Sr. Deputy Commissioners.
- Unit Monitors help ensure monitoring is thorough and implemented throughout the agency.

In addition, DBO also maintains a SLAA risk matrix on the department's intranet, known as "The Vault," which captures the latest risk assessment and mitigation project responsibilities and deadlines. DBO also has the ability to report newsworthy progress to address risks through an internal monthly newsletter, called "The Ledger," and monthly interoffice communications to all employees from the Commissioner.

Ongoing Monitoring Compliance

DBO is in the process of implementing and documenting the ongoing monitoring processes as outlined in the monitoring requirements of California Government Code sections 13400-13407. These processes include reviews, evaluations, and improvements to DBO's systems of controls and monitoring.

RISK ASSESSMENT PROCESS

The following personnel were involved in DBO's risk assessment process: Executive Management, Middle Management, Frontline Management, and Staff.

Risk Identification

Using the SLAA paradigm as a reminder to supervisors and as a guide, DBO surveyed all managers in the Spring of 2017 and asked them to note any prior, current or emerging risks in their areas, breaking each concern down by category/subcategory, risk factor/root cause, date first identified, responsible program/unit, who is impacted, and any mitigating controls. Those risks were then summarized for discussion and consideration by the Risk Management Committee, consisting of DBO senior executive staff, the deputy commissioner of Administration, and the internal audit manager. Since there were no pending single audit findings to address, the team focused on the risks identified and emerging issues related to new programs scheduled for implementation.

Risk Ranking

Prior to 2017 SLAA training through the Department of Finance, the DBO Risk Management Committee considered the risks identified by the supervisors and held a meeting to discuss those which they believed would have the highest impact for the department, and for their own areas. After attending SLAA training, committee members regrouped to focus on the severity or impact of each risk, then discussed the likelihood of those deemed to have the highest consequence, ranking them according to those factors. This report is the result of that discussion.

RISKS AND CONTROLS

Risk: Compliance – External – Responsibilities of Laws or Regulations Clarification

Business Continuity Management Risk
DBO has both current Disaster Recovery and Technology Recovery Plans, but no formal Business Continuity Plan.

Per State Administrative Manual (SAM) 5325, the concept of business continuity is based on the identification of all business functions within a state entity, and then assigning a level of importance to each business function. A business impact assessment is the primary tool for gathering this information and assigning criticality, recovery point objectives, and recovery time objectives, and is therefore part of the basic foundation of contingency planning and business continuity.

What could go wrong?

- Lack of a formal Business Continuity Plan could compromise DBO's responsiveness and recovery after a true disaster, lead to a degradation in service, or undermine the department's statutory requirements.

What is the cause?

- DBO was formed July 1, 2013 from the merger of the Department of Corporations and the Department of Financial Institutions. Each entity brought to the merger unique internal business policies, processes, procedures and controls. Since the merger, the DBO has made great strides to blend and modernize business operations and procedures. Completing a Business Continuity Plan will contribute to that effort.

What is the result?

- Until a formal Business Continuity Plan is completed, DBO remains out of compliance with SAM 5325. Lack of a formal Business Continuity Plan could compromise DBO's responsiveness and recovery after a true disaster, lead to a degradation in service, or undermine the department's statutory requirements.

Control A

As DBO continues to grow and build more capacity, our business processes mature as well. DBO plans to develop a Business Continuity Plan to ensure DBO's responsiveness and recovery after a true disaster. Creating a Business Continuity Plan would mitigate the risk and bring DBO into compliance with SAM 5325.

The department proposes to procure an experienced contract vendor to facilitate the creation of a DBO Business Continuity Plan. We anticipate securing the services by the second quarter of 2018 and completing the plan by the end of calendar year 2018.

Risk: Operations – Internal – Organizational Structure

Human Resources Management Risk

The Human Resources Management risk addresses the availability of an adequate and knowledgeable workforce with sufficient training and skills to meet the organizational goals and objectives into the future. This includes recruitment, hiring, succession planning, and retention. One of the biggest issues affecting cohesion and recruitment/retention within DBO is a bifurcated set of classifications within the department's examiner series (Corporation Examiner and Financial Institutions Examiner), the most prevalent positions within the department.

DBO was formed from two distinct departments, DOC and DFI, which each had unique classifications tailored to ensure that entities were properly licensed, assessed, examined, and that applicable laws were properly enforced. When the two agencies became one, the classifications remained distinct between the two examination divisions, which were renamed the Division of Corporations and the Division of Financial Institutions. After the consolidation, DBO commissioned a formal classification study from CPS HR Consulting; the final report arrived in March 2016. It concluded that the tasks, minimum qualifications, knowledge, skills and abilities required were substantially similar between both examiner series at all levels, and recommended consolidation of the classifications. However, with collective bargaining changes, while the duties remained substantially similar, salary differences began to widen. As an example: entry-level and initial classifications within the DOC career ladder, including Auditor I, Corporation Examiner, and Corporation Examiner IV (Specialist), are now 5-6% lower than the corresponding DFI career ladder, which includes the following classifications: Financial Institutions Examiner and Senior Financial Institutions Examiner.

What could go wrong?

- Failure to address the current salary differences creates dissension between the two divisions, as employees performing substantially similar work receive different levels of compensation. The disparity depresses morale, and can also create difficulties in hiring and retaining personnel in the DOC classifications. New applicants for vacancies may bypass or decline DOC positions when they realize that DFI positions pay more. Also, current DOC employees may apply for DFI vacancies and abandon their DOC positions in order to receive higher compensation. Maintaining two disparate classification series also decreases transferability of skills and upward mobility opportunities within the department, as employees must assert that they meet higher minimum qualification standards for transfer, and DBO must manage multiple examinations with dwindling candidate pools.

What is the cause?

- California's Department of Human Resources (CalHR) is reviewing all classifications within the state system in order to streamline operations – eliminating unused classes, and eliminating department-specific classes in favor of consolidated, standardized statewide classifications which perform similar workloads, and which mirror federal occupational series. CalHR notified DBO in April 2016 that DBO's examiner classification consolidation would be considered as part of the overall statewide effort in Fall 2016. However, every quarter, the deadline has been pushed back and remains unresolved. Recent discussions with CalHR have indicated that this consolidation may not occur anytime soon due to staffing and resource constraints.

What is the result?

- Dissension, depressed morale, difficulty recruiting, hiring and retaining personnel as both new applicants and current DOC employees favor the more highly-compensated DFI vacancies, challenges to upward mobility, elevated workloads to maintain multiple examinations, decreased levels of eligible candidates for vacancies.

CONTROL A

Work with CalHR to complete and submit reclassification proposal packages to transfer personnel in current DOC classifications to corresponding DFI classifications. This proposal would require both CalHR and bargaining unit awareness and approval, but likely will be faster and easier than waiting for a new, consolidated statewide examiner classification in conjunction with CalHR and the State Personnel Board, which could follow. DBO would also need to work through issues related to organizational structure, duty statements, alternate range changes, promotional exam list eligibility and probationary periods, as well as requesting and receiving Department of Finance approval for changes in any reclassifications for the Senior Financial Institution Examiner classification and higher. Consolidation of examiner classifications expands the availability of knowledgeable examiners by enabling transfers between divisions. This change will provide additional opportunities for examiners and will create a workforce with broad knowledge. Both factors should help reduce retention issues.

Risk: Operations – Internal – Technology – Support, Tools, Design, or Maintenance

Paper Dependency Risk

Because of the nature of DBO's regulatory responsibilities (licensing, assessing, auditing, and enforcing regulations for dozens of different types of financial services, lending and other business entities) and the fact the department is only four years old, there are disparate business processes across the organization some of which are still paper intensive. Also, because of the long history of the two departments, there is a significant amount of paper currently being stored.

What could go wrong?

- Dependence on paper documents slows examination and investigatory processes, critical timed responses to Public Records Act requests, and other high-profile requirements, which could result in missed statutory deadlines or other compliance issues. The physical space needed to save hard-copy documents is costly and can lead to storage and safety issues for staff who must navigate, move and locate files.

What is the cause?

- DBO has several types of technology solutions to eliminate paper submissions from licensees as well as scanning technologies currently used by program staff to use when paper is submitted. However, there is currently no department-wide process to scan, store and access documents from a central repository. The department's strategic plan's goal 4 outlines an objective to address this risk.

What is the result?

- Time-consuming processes to properly identify and locate paper documents requires additional staff resources, and slows responses. This creates the potential for missed deadlines for mandated Public Records Act responses and compliance requirements. High volumes of paper documents also lead to higher storage costs and could create safety concerns as staff required to search for documents must navigate, lift, move, search and find applicable documents.

CONTROL A

DBO will identify critical workloads, both historical and current, which constitute high volumes of hard-copy paper documents and create both policy and procedures to image and store these documents for long-term availability and accessibility. This process may involve securing a vendor or service to scan existing documents, or procuring a new system or leveraging an existing one to achieve this outcome. Having these documents available electronically should increase response times and eliminate the possibility of compliance issues. Success would also meet a DBO strategic plan goal to increase efficiency and effectiveness through innovative use of technology and education.

CONCLUSION

DBO strives to reduce the risks inherent in our work and accepts the responsibility to continuously improve by addressing newly recognized risks and revising controls to prevent those risks from happening. I certify our internal control and monitoring systems are adequate to identify and address current and potential risks facing the organization.

Jan Lynn Owen, Commissioner

CC: California Legislature [Senate (2), Assembly (1)]
Californian State Auditor
California State Library
California State Controller
Director of California Department of Finance
Secretary of California Government Operations Agency

N/A
Jan Lynn Owen, Commissioner

Implementation Plan Submitted for:
June 30, 2018

RISKS AND CONTROLS

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Update Without Progress—June 30, 2018

Contact Person(s):

Is the control put into practice: No

Is this control reducing the risk as expected: No

This control is accepted in its current state because: (1) it is an ongoing activity, (2) resources are redirected or unavailable, or (3) it no longer mitigates this risk.

Update Without Progress—December 31, 2017

This is a new SLAA risk identified as part of the 2017-2019 assessment period.

Contact Person(s): Michael Miller

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Is this control reducing the risk as expected: No

What's Next
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Next Milestone: June 30, 2018

Risk: Operations —Internal—Organizational Structure
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Next Milestone: June 30, 2018

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