

December 17, 2021

Lourdes M. Castro Ramirez, Secretary
California Business, Consumer Services and Housing Agency
915 Capitol Mall, Suite 350-A
Sacramento, CA 95814

Dear Secretary Lourdes M. Castro Ramirez,

In accordance with the State Leadership Accountability Act (Leadership Accountability), the Department of Financial Protection and Innovation submits this report on the review of our internal control and monitoring systems for the biennial period ending December 31, 2021.

Should you have any questions please contact Chris Shultz, Acting Commissioner, at (916) 576-8562, Chris.Shultz@dfpi.ca.gov.

GOVERNANCE

Mission and Strategic Plan

The Department of Financial Protection and Innovation (DFPI) 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. Its regulatory purview extends over domestic and foreign banks, credit unions, payday lenders, mortgage lenders, originators and servicers, finance lenders, escrow companies, broker-dealers and investment advisers, money transmitters, as well as premium finance companies, student loan servicers, check sellers, and trust companies. Additionally, DFPI regulates the offer and sale of securities and franchises in California.

The California Consumer Financial Protection Law expanded the Department's oversight in fiscal year 2020-21 to better protect consumers, keep up with emerging financial innovation, and spur responsible job growth. For the first time in its history, the DFPI can oversee providers of certain financial products and services previously unregulated by the Department, such as debt collectors, debt-relief companies, credit reporting agencies, consumer credit repair companies and others. To reflect the expanded oversight, the department's name changed from the Department of Business Oversight to the Department of Financial Protection and Innovation.

The Department of Financial Protection and Innovation's regulatory authority and its licensees are governed by the California Financial Code and Corporations Code. The DFPI's FY 2021-22 budget totals \$132 million, authorizes 770 positions and is funded entirely with special funds derived mainly from fees paid by licensees.

Mission:

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

Vision:

We are a national leader with a mission to protect consumers, foster trust, innovation, and fairness in the financial marketplace.

STRATEGIC PLAN 2020 – 2023

The DFPI Strategic Plan declares the department's vision, mission, values, and goals. With the 2020—2023 strategic goals, we aim to:

- Increase DFPI's protection of consumers
- Expand our services and outreach efforts to all stakeholders
- Grow our succession bench and provide employees more development opportunities
- Maximize operational efficiency

GOAL 1 - Strengthen consumer protection

OUTCOME:

A safe and secure financial services marketplace where Californians recognize the Department and know how to utilize our services.

ACTIONS:

- Communications and outreach prioritizes consumers through expanded resources
- Expand financial education throughout the state
- Launch proactive communication with stakeholders
- Identify trends through complaint data and adjust exam and enforcement protocols to mitigate consumer harm

RESPONSIBILITY:

Multiple programs and divisions

GOAL 2 - Focus on innovative financial products & services

OUTCOME:

Expertise and relationship-building that allows us to keep up with emerging financial products and services and foster responsible innovation that protects consumers and retains jobs in California.

ACTIONS:

- Develop staff expertise in emerging financial products and services
- Cultivate deep knowledge of emerging products and services through early engagement with innovators, investors and other stakeholders

- Develop cross organizational procedures that empower staff to raise awareness and understanding of new products and services

RESPONSIBILITY:

Office of Financial Technology Innovation, Programs

GOAL 3 - Align and strengthen internal business processes

OUTCOME:

Improvements allow us to successfully launch new programs, while new tools help us maximize efficiencies within our Department.

ACTIONS:

- Audit our data to provide a clear path for improvements
- Strengthen, update, and streamline licensee exam processes
- Track our progress on state-specific compliance
- Identify high-risk licensees for targeted examinations
- Modernize internal systems and transition paper-based work to digital
- Improve consumer complaint intake process

RESPONSIBILITY:

All Programs

GOAL 4 - Cultivate a diverse, growth- oriented culture

OUTCOME:

Strengthen staff competencies to develop leaders, and retain and attract top talent.

ACTIONS:

- Deploy 360 reviews to assess and strengthen leadership competencies
- Implement a leadership development program to grow our leadership bench
- Review and improve training offerings
- Utilize cross-training to strengthen program knowledge and competencies
- Broaden HR outreach to promote equity and diversify talent

RESPONSIBILITY:

All Programs

Control Environment

The Department of Financial Protection and Innovation has implemented and documented 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 the Department of Financial Protection and Innovation systems of controls and monitoring.

As head of the Department of Financial Protection and Innovation, Clothilde Hewlett, Commissioner, is responsible for the overall establishment and maintenance of the internal control and monitoring systems.

Executive Monitoring Sponsors

The executive monitoring sponsor responsibilities include facilitating and verifying that the Department of Financial Protection and Innovation internal control monitoring practices are implemented and functioning as intended. The responsibilities as the executive monitoring sponsors have been given to: Clothilde Hewlett, Commissioner; Chris Shultz, Chief Deputy Commissioner; Bret Ladine, General Counsel; Edgar Gill, Senior Deputy Commissioner, Division of Corporations and Financial Institutions; Suzanne Martindale, Senior Deputy Commissioner, Division of Consumer Financial Protection; and Betsy Barnhart, Deputy Commissioner Administration.

Organizational structure to ensure appropriate levels of responsibility and authority:

Each Division within the Department is led by a Deputy Commissioner (DC) and supervisory levels below that. DFPI's Delegation of Authority was revised in February 2021, empowering staff at lower levels to make position-appropriate decisions.

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.

Establishing and maintaining a competent workforce:

In an effort to establish and maintain a competent workforce, DFPI has acted upon its 2020-2024 Workforce Action Plan in the following ways: a) DFPI increased its applicant pool by participating in six virtual college career fair events for recruitment outreach purposes and meeting individually with a total of 124 students in efforts to make DFPI an employer of choice; b) DFPI converted the single examiner/ auditor classification series exam into an online exam, allowing applicants 24-hour access to take the online exams, which has increased the potential candidates for DFPI and made it easier to fill examiner roles; c) DFPI has begun leveraging online job search sites and social media, specifically LinkedIn, which has increased its applicant pools for vacant positions; and d) DFPI is converting its enterprise-wide Competency Training Initiative from in-person to virtual training, and will be rolling out training in 2022.

Information and Communication

The results of monitoring activities for DFPI-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 DFPI 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 DFPI chain of command. All levels of management are involved in assessing and strengthening internal control systems per Government Code section 13041, subdivision (b)(3). Agency monitoring is performed by the Commissioner, Chief Deputy Commissioner, and Senior Deputy Commissioners. Unit monitors help ensure that monitoring is thorough and implemented throughout the department. DFPI also may report newsworthy progress to address risks through an internal bi-monthly newsletter, called "The Ledger".

MONITORING

The information included here discusses the entity-wide, continuous process to ensure internal control systems are working as intended. The role of the executive monitoring sponsor includes facilitating and verifying that the Department of Financial Protection and Innovation monitoring practices are implemented and functioning. The responsibilities as the executive monitoring sponsor(s) have been given to: Edgar Gill, Senior Deputy Commissioner; Chris Shultz, Acting Commissioner; Harun Lomanto, Chief of Internal Audit; and Betsy Barnhart, Deputy Commissioner, Administration.

Monitoring Activities

All levels of DFPI management and personnel are responsible for ensuring that adequate internal controls are in place within their respective program areas. DFPI 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. DFPI'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 DFPI (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 DFPI'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. DFPI'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 risks 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 DFPI Commissioner.

RISK ASSESSMENT PROCESS

The following personnel were involved in the Department of Financial Protection and Innovation risk assessment process: executive management, middle management, front line management, and staff.

The following methods were used to identify risks: brainstorming meetings, employee engagement surveys, ongoing monitoring activities, audit/review results, other/prior risk assessments, external stakeholders, questionnaires, consideration of potential fraud, and performance metrics.

The following criteria were used to rank risks: likelihood of occurrence, potential impact to mission/goals/objectives, timing of potential event, potential impact of remediation efforts, and tolerance level for the type of risk.

RISKS AND CONTROLS

Risk: DFPI Lotus Notes System

The DFPI Lotus Notes System, which encompasses departmental administrative functions such as timekeeping, procurements, contracts, and Human Resources Requests for Personnel Actions is a 20-year-old legacy system that is heavily reliant on the support of an external contractor. Limited internal support was provided by an IT administrator that had over 15 years of Lotus Notes System administration experience; however, that administrator has recently retired from state service. The IT risk is if the system should ever fail or if external contractor support is lost, IT will not have the internal expertise to get the system back up and running. Lotus Notes is not a widely used industry software platform which makes it impossible to find state expertise and very difficult to find external vendor support. DFPI's IT office (ITO) experienced difficulty finding qualified vendors during the last procurement period.

Control: Analyzing alternative software

IT is performing analysis on alternative Software-as-a-Service (SaaS) products recommended by the California Department of Technology that encompass the same functions that Lotus Notes provides. The solution may require multiple SaaS products to replace all of the functionality of the current system. The priority of these projects will be presented to the Department's IT Change Advisory Board (IT CAB) as alternative products are identified.

Human Resources Office (HRO) has already begun the process of implementing a new timekeeping system. In the next year, the department will work to find a new Human Resources

Information System (HRIS) which will replace the Request for Personnel Action (RPA) system to track and hire positions. Business Operations Office (BOO) is evaluating if transferring requisitions (Form 5) to the California Department of Financial Information System for California (FI\$Cal) will meet the needs of the Department.

Risk: Tracking equipment assigned to remote staff

With the continuance of remote work, the risk of not receiving state owed assets from separating staff is higher.

Separating staff may refuse to return equipment. The Department has 3 recourses: (1) Bill for the cost of equipment; (2) fill-out theft of state equipment and inform CHP; or (3) inform Franchise Tax Board of the receivable to collect from the employee.

Equipment inventory is depleted and new stock must be purchased.

Control: Using separation checklist & including assets-return in HRIS

A separation checklist is used by department managers, BOO, FMO, ITO, HRO to verify that equipment is returned.

Include return of state assets in a new Human Resources Information System (HRIS)

Risk: Remote work impacts to training examiners

The current pandemic remote work posture impacts the hiring, onboarding and training of examiners. This impacts how quickly examiners learn their job function, which delays their productivity and consequently lowers the quality of examinations.

Control: Exploring new ways to train in virtual environment

The Department continues to explore new ways to train staff using the virtual environment by developing examination standards using virtual tools to increase the knowledge and productivity of examiners.

CONCLUSION

The Department of Financial Protection and Innovation strives to reduce the risks inherent in our work and accepts the responsibility to continuously improve by addressing newly recognized risks and revising risk mitigation strategies as appropriate. I certify our internal control and monitoring systems are adequate to identify and address current and potential risks facing the organization.

Chris Shultz, Acting Commissioner

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