

December 21, 2017

Michael Cohen, Director
California Department of Finance
915 L Street
Sacramento, CA 95814

Dear Mr. Michael Cohen,

In accordance with the State Leadership Accountability Act (SLAA), the Department of Insurance 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 Joel Laucher, Chief Deputy Insurance Commissioner, at (415) 538-4381, joel.laucher@insurance.ca.gov.

BACKGROUND

The California Department of Insurance (CDI) was created in 1868 as part of a national system of state-based insurance regulation. The insurance market place has changed dramatically over time, but consumer protection continues to be the core of the CDI's mission. Today, CDI is the largest consumer protection agency in the state. With annual direct premiums of \$288 billion, California is the largest insurance market in the United States and the sixth largest insurance market in the world. Nearly 1,400 dedicated employees work at the CDI to oversee more than 1,300 insurance companies and license more than 400,000 agents, brokers, adjusters, and business entities.

In the normal course of business, the CDI annually processes more than 8,000 rate applications, issues approximately 190,000 licenses (new and renewals) and performs hundreds of financial reviews and examinations of insurers doing business in California. CDI annually receives more than 170,000 consumer assistance calls, investigates more than 37,000 consumer complaints and, as a result, recovers more than \$84 million a year for consumers. The CDI also annually receives and processes tens of thousands of referrals regarding suspected fraud against insurers and others and conducts criminal investigations resulting in thousands of arrests every year. All of the CDI's functions, including overseeing insurer solvency, licensing agents and brokers, conducting market conduct reviews, resolving consumer complaints, and investigating and prosecuting insurance fraud, are to protect consumers.

Consumers, insurance companies, and licensees rely on the CDI to ensure that insurance products and services are available to consumers timely, and that they deliver fair and equal benefits. To meet these expectations, the CDI ensures that insurers are solvent, consumer complaints are addressed in a reasonable manner, and insurers and licensees play fairly in the marketplace. In 1988, California voters passed Proposition 103, a citizen-led initiative. Proposition 103 expanded the CDI's authority as well as changed the Insurance Commissioner from an appointee of the Governor to an independent statewide officer elected by popular vote. Proposition 103 also required prior approvals of property and casualty rates, including personal auto and homeowner insurance. CDI enforces the insurance laws of California and has authority over how insurers and licensees conduct business in California. License fees, assessments, and Proposition 103 recoupment fees are the primary sources of funding for the CDI.

ONGOING MONITORING

As the head of Department of Insurance, Dave Jones, Insurance 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 Department of Insurance internal control monitoring practices are implemented and functioning as intended. The responsibilities as the executive monitoring sponsor(s) have been given to: Lisa Keeler, Chief, Enterprise Planning , Risk, and Compliance.

MONITORING ACTIVITIES

CDI Designated Branch Ongoing Monitors report through their daily organizational reporting hierarchy and to the CDI Ongoing Monitoring process. The CDI Internal Control Assessment Matrix is used to document and report ongoing monitoring. All internal controls evaluated include whether the internal control complies or does not comply with the intended degree of risk assessment. The CDI SLAA Agency Monitor assures the risk assessment database is updated according to the CDI Internal Control Assessment Matrix. Quarterly CDI Ongoing Monitor meetings are scheduled to review the CDI ongoing monitoring effort.

ADDRESSING VULNERABILITIES

The role of the CDI Designated Branch Ongoing Monitor is to facilitate and verify the CDI's internal control practices. The Branch Ongoing Monitor is experienced in discerning the 'due diligence' of business processes. The responsibilities of the designated CDI Internal Control Monitors are to: Review existing internal controls for operation effectiveness and efficiency. Affect internal controls that mitigate risk. Document the monitor process structure and practices. Document and summarize the results of monitoring activities. Attend, engage, and collaborate at quarterly Internal Control Ongoing Monitor meetings. Be objective and unbiased and maintain an attitude of impartiality, integrity, and a questioning state of mind. Attend training to develop knowledge and skills regarding internal control and monitoring activities. Advise unit employees on monitoring processes and activities.

COMMUNICATION

Quarterly meeting are scheduled on the last Thursday of the first month of each quarter. The purpose of the meetings are to: Communicate the Ongoing Monitoring Process. Discuss and document the monitoring through the reporting of internal control testing. To establish 10% internal control testing and provide additional training if needed. Evaluate and improve the Ongoing Monitoring Process.

ONGOING MONITORING COMPLIANCE

The Department of Insurance 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 Insurance systems of controls and monitoring.

RISK ASSESSMENT PROCESS

The following personnel were involved in the Department of Insurance risk assessment process: Executive Management, and Middle Management.

RISK IDENTIFICATION

The Organizational Accountability Office (OAO) facilitates the CDI branches' annual risk assessment process. The Office of Strategic Planning (OSP) facilitates CDI's strategic objectives. In partnership, the CDI branches coordinate with OSP to ensure that CDI risks align with strategic objectives, which are derived from their branch/program activities.

Branches identify the risks that may impede them from achieving objectives. A list of risks is located in the main menu page of the CDI Risk Assessment database.

In the CDI Risk Assessment database, objectives are categorized as:

- Strategic
- Operation
- Reporting
- Compliance

The risk to these objectives is subdivided into internal and external source. Examples of the risks related to the objective type are provided for each internal and external source. Such as - Objective: Operation – External – Sources, Levels. Resources used to finance an entity objective may be reduced, discontinued, or difficult to obtain. Examples:

- Entity is heavily reliant on non-guaranteed federal funds
- Depletion of available bond funds
- Decline in private donations
- Complex grant application requirements create challenges for an entity.

RISK RANKING

The selection of the risk strategy depends on the costs and effectiveness.

- Accept. Take on the risk without any mitigation.
- Transfer. Share some of the risk, such as through reinsurance.
- Mitigate. Take on the risk but apply mitigation to minimize the risk to an acceptable level.
- Avoid. Get out of this line of business which objective has this associated risk.

RISKS AND CONTROLS

RISK: COMPLIANCE-EXTERNAL-COMPLEXITY OR DYNAMIC NATURE OF LAWS OR REGULATIONS

The Health Policy and Reform Branch (HPAB) reviews, analyzes, and develops policy positions on health insurance issues through close collaboration with other branches, as well as other state and federal agencies and stakeholders.

HPAB is to help oversee state-level efforts to implement federal health care reform in health insurance and assists in the development of health-related policy initiatives. Two of their activities include:

- The implementation of Health Care Reform; and
- The implementation of ongoing changes to federal and state health insurance law and regulations.

The objectives of these activities are to:

- Work to implement the new health care laws.
 - Work to implement new health insurance laws and regulations.
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The risks factors of these objectives are:

- The complexity or dynamic nature of laws or regulations.
- The difficulty to interpret changing requirements of laws or regulations.

CONTROL A

To help mitigate this risk, HPAB will advocate and sponsor health care law in coordination with the Legislative Branch.

CONTROL B

To help mitigate this risk, HPAB will comply with statute and policy. In addition, instill supervisory review over the process.

RISK: COMPLIANCE-INTERNAL-RESOURCE LIMITATIONS

The Enforcement Branch (EB) regulates, investigates, audits, and trains members of the insurance industry to ensure that companies comply with applicable insurance law and regulations, and remain solvent and meet their obligations to insurance policyholders. The branch protects consumers by investigating and prosecuting individuals, employers, companies and licensees accused of insurance code violations, including fraud. One of their activities include:

- The evaluation of insurers' compliance with Special Investigative Unit laws and regulations.

The objective of this activity is to:

- Evaluate insurers' compliance to train their staff and report suspected insurance fraud to CDI (and local district attorney for workers' comp insurance fraud).

The risk of this objective is:

- Insufficient staffing and travel budget to comply with audit requirements per California Insurance Code.

The Rate Regulations Branch (RRB) analyzes and approves filings submitted by property and casualty insurers and other insurance organizations under California's statutes relating to prior approval of rates. One of their activities include:

- The review of property and casualty rates and class plan filings, including the good driver discount for personal auto.

The objective of this activity is to:

- Ensure the class plan rating factors are in compliance with the statutes and regulations and each insurer's rating plan adheres to the good driver statutes, applying the mandatory 20% discount.

The risk of this objective is:

- Inadequate staffing.

CONTROL A

To mitigate this risk, EB and RRB will:

- Prepare the annual audit plan based on risk assessment and execute accordingly; and
- Scale back the level of review and/or pursue budget change proposals to meet workload demands.

RISK: COMPLIANCE-INTERNAL-STAFF ADHERENCE TO POLICIES, PROCEDURES, OR STANDARDS

The Enforcement Branch (EB) regulates, investigates, audits, and trains members of the insurance industry to ensure that companies comply with applicable insurance law and regulations, and remain solvent and meet their obligations to insurance policyholders. The branch protects consumers by investigating and prosecuting individuals, employers, companies and licensees accused of insurance code violations, including fraud. One of their activities include:

- The intake, packaging, chain of custody, and final disposition of criminal evidence is compliant with law, EB policy and procedures, and best practices.

The objective of this activity is to:

- Ensure evidence staff are available and knowledgeable regarding the intake, packaging, safeguarding and disposition of evidence.

The risk of this objective is:

- Staff not trained and/or experienced in evidence policy and procedures.

CONTROL A

To mitigate this risk, EB will:

- Conduct training,
- Perform inspections,
- Complete inventories,
- Conduct reviews, and/or audits to ensure staff are trained and/or experienced in evidence policy and procedures.

RISK: OPERATIONS -EXTERNAL-FUNDING—SOURCES, LEVELS

The Enforcement Branch (EB) regulates, investigates, audits, and trains members of the insurance industry to ensure that companies comply with applicable insurance law and regulations, and remain solvent and meet their obligations to insurance policyholders. The branch protects consumers by investigating and prosecuting individuals, employers, companies and licensees accused of insurance code violations, including fraud. One of their activities include:

- The administration and oversight of the Life and Annuity Consumer Protection Program grant program, including the request for application process, monitoring program budgets, statistical reporting, regulatory oversight, and budget change proposals.

The objective of this activity is to:

- Help ensure the Districts Attorney use the grant monies efficiently and effectively, and in compliance with the California Insurance Code.

The risk of this objective is:

- Insufficient funding to provide proper investigative and prosecution resources.

CONTROL A

To mitigate this risk, EB will coordinate with Budgets and Legislative staff internally and externally to ensure sufficient funding to provide proper investigative and prosecution resources.

RISK: OPERATIONS -EXTERNAL-STAFF—RECRUITMENT, RETENTION, STAFFING LEVELS

The Financial Surveillance Branch (FSB) assures that all insurers licensed to do business in California (as well as those insurers operating on a non-admitted or surplus lines basis) maintain the financial stability and viability necessary to provide the benefits and protection promised to California policyholders. One of their activities include:

- Actuarial services.

The objectives of these activities are to:

- Focus recruiting efforts to enable program to attract and retain qualified staff at all levels of experience, as needed; develop entry-level hires into fully professionally qualified actuaries, and
- Monitor impact of recent salary adjustments on recruitment and retention efforts.

The risk of these objectives is:

- The inability to attract and retain qualified actuaries at all levels as needed.

CONTROL A

To mitigate this risk, FSB will continue to work with CalHR on a detailed comprehensive classification and compensation proposal affecting five separate state agencies; which was submitted to them in June 2013. As of September 2017, it has still not been approved, but current indications are that approval may occur within the next 12 months.

RISK: OPERATIONS -INTERNAL-STAFF—KEY PERSON DEPENDENCE, WORKFORCE PLANNING

The Administrative Hearing Bureau (AHB) assists the Commissioner in performing adjudicatory tasks provided for by statute or regulation. This is accomplished by:

- Conducting hearings.

The objective of this activity is to:

- Conduct fair and impartial hearings in accordance with the Administrative Procedures Act and applicable laws and regulations.

The risk of this objective is:

- Retaining qualified and talented Administrative Law Judges.

CONTROL A

To mitigate this risk, AHB will offer professional development training, modernized hearing rooms and offices to be more conducive to professional working conditions.

RISK: OPERATIONS -EXTERNAL-STAFF—RECRUITMENT, RETENTION, STAFFING LEVELS

The Administrative Hearing Bureau (AHB) assists the Commissioner in performing adjudicatory tasks provided for by statute or regulation. This is accomplished by:

- Conducting hearings.

The objective of this activity is to:

- Conduct fair and impartial hearings in accordance with the Administrative Procedure Act, the California Insurance Code, and other applicable laws and regulations.

The risks of this objective is:

- Inadequate candidate pool, and
- Pay disparity between Administrative Law Judges and Attorneys working for the State makes it impossible to recruit adequately trained and experienced candidates.

The Health Policy and Reform Branch (HPAB) reviews, analyzes, and develops policy positions on health insurance issues through close collaboration with other branches, as well as other state and federal agencies and stakeholders. Helps oversee state-level efforts to implement federal health care reform in health insurance and assists in the development of health-related policy initiatives. One of their activities include:

- The review of Health Insurance Rates.

The objective of this activity is to:

- Review individual and small group health insurance rates prior to their implementation, with the goal of preventing unreasonable rates from being charged to consumers.

The risk of this objective is:

- Difficulty in hiring and retaining sufficient actuarial resources.

CONTROL A

To mitigate this risk, AHB will:

- Provide state of the art courtrooms, and
- Provide excellent training opportunities, along with flexible work schedules.

This will provide an adequate candidate pool.

CONTROL B

To mitigate this risk, AHB will try to recruit in non-traditional ways (advertising on the internet, bar associations, etc.).

CONTROL C

To mitigate this risk, HPAB will actively recruit qualified actuarial skilled staff. Change the salary scale for some actuarial positions and change the minimum qualifications for others to accurately reflect the experience necessary to do these jobs.

RISK: OPERATIONS -EXTERNAL-STAFF—RECRUITMENT, RETENTION, STAFFING LEVELS

The Administrative Hearing Bureau (AHB) assists the Commissioner in performing adjudicatory tasks provided for by statute or regulation. This is accomplished by:

- Conducting hearings.

The objective of this activity is to:

- Conduct fair and impartial hearings in accordance with the Administrative Procedure Act, the California Insurance Code, and other applicable laws and regulations.

The risk of this objective is:

- Inadequate candidate pool for Senior Legal Typists and Legal Secretaries.

CONTROL A

AHB will accept this risk.

RISK: OPERATIONS -INTERNAL-STAFF—TRAINING, KNOWLEDGE, COMPETENCE

The Community Programs and Policy Initiatives (CCPI) connects CDI with consumers by creating and sustaining partnerships with community groups, consumer organizations, small businesses, nonprofits, insurance industry organizations, federal, state and local government entities, and individuals. This branch is also responsible for analyzing emerging insurance issues with policy implications and helps implement policy initiatives. One of their activities include:

- Funding source.

The objective of this activity is to:

- Calculate assessments.

The risk of this objectives is:

- Insurance companies not complying with the request.

The Enforcement Branch (EB) regulates, investigates, audits, and trains members of the insurance industry to ensure that companies comply with applicable insurance law and regulations, and remain solvent and meet their obligations to insurance policyholders. The branch protects consumers by investigating and prosecuting individuals, employers, companies and licensees accused of insurance code violations, including fraud. One of their activities include:

- The ability to conduct Field Enforcement Operations (arrest warrants, search warrants, surveillance, subpoenas, service of process and evidence collection).

The objective of this activity is to:

- Conduct investigative and enforcement activities in a safe and professional manner, while achieving the goal of the assignment as directed via bi-monthly case and performance reviews for detectives.

The risk of this objective is:

- The hiring/retaining of quality candidates that are trained and provided safety equipment in compliance with Peace Officer Standards and Training (POST) and Enforcement Branch policy.

CONTROL A

To mitigate this risk, CPPI will:

- Send a letter to the insurance company CEO,
- Enforce the California Insurance Code, and
- Request Legal Branch to assist in obtaining data.

CONTROL B

To mitigate this risk, EB will:

- Perform an annual review of the Training Program,
- Do quarterly inspection of firearms,
- Conduct job fairs and utilize social media to increase candidate pool, and
- Pursue pay parity with other state departments.

RISK: OPERATIONS -EXTERNAL-OVERSIGHT OF OR PROGRAM COORDINATION WITH OTHERS

The Enforcement Branch (EB) regulates, investigates, audits, and trains members of the insurance industry to ensure that companies comply with applicable insurance law and regulations, and remain solvent and meet their obligations to insurance policyholders. The branch protects consumers by investigating and prosecuting individuals, employers, companies and licensees accused of insurance code violations, including fraud. This is accomplished by:

- Staffing of the Enforcement Branch.

The objective of this activity is to:

- Ensure Fraud Division and Investigation Division vacancies are filled timely in compliance with state rules and department policy.

The risks of this objective are:

- Lack of pay parity with other state agencies, and
- Complexity and hiring requirements to do background checks impacts the timeliness to fill vacancies.

CONTROL A

To mitigate this risk, EB will:

- Seek action by calHR to create pay parity.
- Provide vacancy reports to Enforcement Branch Deputy Commissioner, Staff Services Manager III, Fraud Division Chief, Assistance Chiefs, and Investigation Division Chief.
- Identify ways to streamline hiring process.
- Utilize job fairs and social media to increase candidate pool.
- Encourage the hiring supervisors to select candidates from recruitment efforts.

RISK: OPERATIONS -INTERNAL-STAFF—TRAINING, KNOWLEDGE, COMPETENCE

Special Counsel provides independent legal advice directly to the Insurance Commissioner, provides oversight of Department Rulemaking Projects and Regulations, directs the interaction with the National Association of Insurance Commissioners (NAIC), and manages various special projects and Commissioner-initiated activities. One of their activities include:

- Writing proposed decisions.

The objective of this activity is to:

- Thorough, well-grounded written decisions.

The risk of this objective is:

- The retention of qualified and talented Administrative Law Judges.

The Office of Strategic Planning (OSP) coordinates the Succession Planning and Workforce Development, including development and implementation of department-wide and program level goals and objectives to address succession planning and workforce development that are aligned with the strategic plan. One of their activities include:

- The Workforce Development and Succession Plan.

The objective of this activity is to:

- Assist CDI in building a department-wide framework to assist all employees tasked with delivering many of the mission critical services.

The risk of this objective is:

- The lack of participation and support by leaders in the organization.

The Health Policy and Reform Branch (HPAB) reviews, analyzes, and develops policy positions on health insurance issues through close collaboration with other branches, as well as other state and federal agencies and stakeholders. Helps oversee state-level efforts to implement federal health care reform in health insurance and assists in the development of health-related policy initiatives. Two of their activities include:

- Policy and Regulatory work, and
- Providing actuarial advice and support to the Commissioner, Executive Staff, and other Department branches regarding health and disability insurance and health care reform.

The objectives of these activity are to:

- Draft regulations and work on public policy to do with health insurance regulation. Undertake public policy research, develop recommendations, and support implementation, and
- Advise Commissioner, Executive Staff, and Department branches on actuarial issues related to health insurance rates so that they can make informed policy decisions.

The risks of these objectives are:

- Inadequate staff training and supervision in promulgating complex regulations, and
 - Inadequate actuarial advice.
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CONTROL A

To mitigate this risk, Special Counsel will offer professional development training, modernized hearing rooms and offices to be more conducive to professional working conditions, along with flexible schedules.

CONTROL B

To mitigate this risk, OSP will involve CDI's Workforce and Succession Planning Committee members, Executive and Senior Leaders, Managers and Supervisors, and represented employees, while utilizing various forms of communication.

CONTROL C

To mitigate this risk, HPAB will hire qualified staff, supervise, educate, train, and perform staff reviews.

CONTROL D

To mitigate this risk, HPAB will comply with statute and policy. Along with instilling a supervisory review of the process.

RISK: OPERATIONS -INTERNAL-ORGANIZATIONAL STRUCTURE

The Business Management Bureau (BMB) is to meet CDI's needs for administrative management and services, including emergency procedures. One of their activities include:

- The Continuity Plan for Business.

The objective of this activity is to:

- Coordinate recovery of critical business functions in managing and supporting the business recovery in the event of a facilities (office building) disruption or disaster.

The risk of this objective is:

- In the event of a disaster, CDI will not be able to perform and maintain critical business functions in one or multiple office locations statewide.

CONTROL A

To mitigate this risk, BMB will update the Continuity Plan with the most current information at least annually, including business processes, emergency procedures, and contact information. Conduct table top exercises annually including training the Disaster Recovery Team and testing of recovery procedures.

CONCLUSION

The Department of Insurance 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.

Dave Jones, Insurance 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