

SUBCOMMITTEE NO. 4

Agenda

Senator Maria Elena Durazo

Senator Jim Nielsen

Senator Thomas J. Umberg



Thursday, March 21, 2019
9:30 a.m. or Upon Adjournment of Session
State Capitol - Room 2040

Consultant: Joe Stephenshaw

PROPOSED FOR VOTE-ONLY

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ISSUES PROPOSED FOR VOTE-ONLY

0509 GOVERNOR'S OFFICE OF BUSINESS AND ECONOMIC DEVELOPMENT

Issue 1: Information Technology Infrastructure and Desktop Support Services

Governor's Budget. The Governor's budget requests \$487,000 General Fund and three positions beginning in fiscal year 2019-20 and ongoing to meet the additional workload requirements associated with the transfer of infrastructure and desktop support responsibilities from the Governor's Office to the Governor's Office of Business and Economic Development (GO-Biz).

Background. The Governor's Office previously provided information technology support services, such as networking and desktop support, to GO-Biz. Last year, the Governor's Office decided to stop providing this support to GO-Biz and completed the transition of responsibility in October.

GO-Biz is a small department that has been growing rapidly as the state has expanded several existing programs, including the I-Bank and the California Film Commission. Last year, GO-Biz received funding for two additional information technology staff to support application development and cloud services that support GO-Biz programs. Several of these projects have been delayed or deferred, however, because existing staff have had to take on the additional technology support workload previously provided by the Governor's Office. For example, planned improvements to a permit assistance tool called CalGOLD have been delayed by several months.

Staff Recommendation. Approve as budgeted.

Issue 2: Zero Emission Vehicle Infrastructure Unit

Governor's Budget. The Governor's budget requests \$767,000 in budget authority from the Air Pollution Control Fund for 2019-20 and ongoing, as well as four positions. This request will provide permanent staff and a secure funding source for the GO-Biz Zero Emission Vehicle Infrastructure Unit as well to replace temporary inter-agency agreements.

Background. In March 2012, Executive Order B-16-2012 set goals of establishing infrastructure to support one million ZEVs by 2020 and deploying one and a half million ZEVs by 2025. This Executive Order led to the publication of two ZEV Action Plans (2013 and 2016) as well as a 2018 Priorities Update; all three of which detail key actions for each state agency to take to enable the ZEV market and specifically call attention to GO-Biz's pivotal role in helping achieve this goal.

In January 2018, Governor Brown issued Executive Order B-48-18 setting a target of five million ZEVs on California roads by 2030 and setting infrastructure deployment targets aimed at enabling California to meet its one and a half million ZEVs by 2025 goal. Within Executive Order B-48-18, GO-Biz is the only agency directly identified by name. GO-Biz is tasked with developing a Plug-in Charging Station Development Guidebook, as well as updating the Hydrogen Station Permitting Guidebook. Additionally, the Governor's Office has tasked GO-Biz with leading the implementation of the full breadth of the Executive Order including developing the 2016 ZEV Action Plan Priorities Update,

coordinating agency actions, and increasing transparency and participation among private, local, regional, state and federal stakeholders.

The current program has been in place since 2014, utilizing temporary position authority and the temporary help blanket at GO-Biz. The GO-Biz ZEV Infrastructure Unit is currently supported by four temporary help blanket positions. The positions are funded through inter-agency agreements with the California Air Resources Board (CARB) and the California Energy Commission. The agreements have been in place since the inception of the ZEV initiatives and are set to expire by 2019-20. GO-Biz is requesting approval to permanently establish the requested positions with a reliable funding source, the Cost of Implementation Account-Air Pollution Control Fund. The CARB is the administrator of that fund and concurs with the proposal.

Staff Recommendation. Approve as budgeted.

0840 STATE CONTROLLER'S OFFICE (SCO)

Issue 3: Leasing Costs Adjustment

Governor's Budget. The Governor's budget requests \$455,000 General Fund in 2019-20 and ongoing to fund leasing cost adjustments.

Background. The operating costs for SCO facilities increase by both step increases to the base fees, and adjustments for the Consumer Price Index (CPI), as outlined in the terms of the lease agreements. SCO is legally required to pay the increased fees. These rates were built into the lease agreements and cannot be absorbed by SCO. The annual Price Letter adjustment would have historically covered the CPI increases for this cost. However, driven primarily by the recession, in 2009-10 statute was enacted that eliminated automated price increases for state entities unless they were provided in the annual budget act. As such, 2009-10 was the last time that the SCO received an automatic operating expense adjustment. SCO cannot absorb these indexed operating costs without seriously impacting other programs.

Staff Recommendation. Approve as budgeted.

1701 DEPARTMENT OF BUSINESS OVERSIGHT (DBO)

Issue 4: Internal Audit Unit Workload

Governor's Budget. The Governor's budget requests \$149,000 in 2019-20 and \$140,000 ongoing for one Associate Management Auditor position to provide ongoing independent, objective evaluation and assessment of operational effectiveness and program compliance.

Background. Government Code Section 1237 requires state agencies with an aggregate spending of \$50 million or more annually to consider establishing an ongoing audit function. Government Code Section 13885 references the importance of internal audit activity to public accountability and governance. In 2015-16, the DBO's appropriation reached \$89 million. The Internal Audit Unit (IAU)

was established in 2016-17 following the consolidation of the Department of Corporations and the Department of Financial Institutions to form the DBO.

The IAU serves the DBO and financial services consumers by ensuring DBO examination programs are functioning as intended in performing sound examinations to prevent consumer harm, and operations are effective to facilitate resource utilization and mitigate improper use of state resources.

The IAU reports directly to the commissioner of the DBO, and its role is to provide independent and objective assurance and consulting activity that is guided by a philosophy of adding value to improve the operations of a department. It is responsible for performing internal audits and coordinating external audits to ensure a systematic, disciplined approach to evaluate program effectiveness and mitigate risk throughout the DBO. The IAU not only directly affects the DBO, but also provides value to California taxpayers by ensuring effective use of resources and safeguarding public funds.

At the time IAU was established, the DBO had not performed a department-wide risk assessment to determine the appropriate staffing level needed to monitor the effectiveness of programs. As a result, only two positions (one Senior Management Auditor and one Associate Management Auditor) were requested and approved. The DBO later performed a department-wide risk assessment leading to the development of an annual audit plan which calls for approximately 11 annual audits, including all special management requested audits, averaging 5,280 total audit hours per year. This exceeds the available 3,520 hours with two staff resources.

Staff Recommendation. Approve as budgeted.

ISSUES PROPOSED FOR DISCUSSION/VOTE

0509 GOVERNOR'S OFFICE OF BUSINESS AND ECONOMIC DEVELOPMENT

Overview. The Governor's Office of Business and Economic Development (GO-Biz) provides a single point of contact for economic development, business assistance and job creation efforts. The GO-Biz works with companies and organizations across the nation to market the benefits of doing business in California, recruit new businesses, retain businesses, and support private sector job growth. The GO-Biz serves as the Governor's lead entity for economic strategy and the marketing of California on issues relating to business development, private sector investment, economic growth, export promotion, permit assistance, innovation and entrepreneurship. Following are the programs within GO-Biz's budget:

- **GO-Biz.** The GO-Biz serves as the Governor's lead entity for economic strategy and the marketing of California on issues relating to business development, private sector investment, and economic growth, and export promotion. This program makes recommendations to the Governor and the Legislature regarding policies, programs, and actions to advance statewide economic goals.
- **California Business Investment Services.** This program serves employers, corporate executives, business owners, and site location consultants who are considering California for business investment and expansion. This program convenes teams on key business development issues. This program works with local, state, and federal partners to attract, retain, and grow businesses in addition to providing permit assistance and helping businesses succeed in California. The Innovation Hub (iHub) initiative improves the state's national and global competitiveness by stimulating partnerships, economic development, and job creation around specific research clusters through state-designated iHubs.
- **Office of the Small Business Advocate.** The director of the Office of the Small Business Advocate (OSBA) serves as the principal advocate in the state on behalf of small businesses, including legislation and administrative regulations that affect small business. The OSBA is responsible for disseminating information about programs and services provided by the state that benefit small businesses, and how small businesses can participate in these programs and services. The OSBA responds to issues from small businesses concerning the actions of state agencies, state laws and regulations adversely affecting those businesses. The OSBA maintains and distributes an annual list of persons serving as small business ombudsmen throughout state government.
- **California Film Commission.** The California Film Commission (CFC) enhances California's status as the leader in motion picture, television and commercial production. The Commission is tasked with retaining and increasing motion picture production and to see that it continues to create jobs and boost business throughout the State. A one-stop office for filmmakers, the Commission supports productions of all sizes and budgets with a variety of services. In addition to issuing film permits for all state properties, administering the film and TV tax credit program, maintaining an extensive location library, and offering production assistance on a wide variety of issues, CFC also works

closely with cities and counties with the goal of creating “film friendly” policies that are consistent statewide.

- **Division of Tourism.** The California Tourism Market Act provides for the marketing of California through an assessment of businesses that benefit from travel and tourism. The objective of the Tourism Assessment Program is to identify potentially assessable businesses, assist companies with determining the appropriate amount of their self-assessment, and collect the fee.
- **California Infrastructure and Economic Development Bank.** California Infrastructure and Economic Development Bank (IBank) was created to finance public infrastructure and private development that promote a healthy climate for jobs, contribute to a strong economy and improve the quality of life in California communities. IBank has a broad authority to issue tax-exempt and taxable revenue bonds, provide financing to public agencies, provide credit enhancements, acquire or lease facilities, and leverage State and Federal funds. IBank's current programs include the infrastructure state revolving fund, 501(c)(3) tax-exempt and taxable revenue bond program, industrial development revenue bond program, exempt facility revenue bond program, governmental bond program and the Clean Energy Finance Center (CEFC) and the Statewide Energy Efficiency Program under the CEFC.
- **Small Business Loan Guarantee Program.** The Small Business Loan Guarantee Program (SBLGP) promotes local economic development by providing guarantees for loans issued to small businesses from financial institutions, typically banks, that otherwise would not approve a term loan or line of credit to a small business. As a result of the SBLGP, participating small businesses are able to secure financing that allows them to grow and expand their business. The loan guarantee serves as a credit enhancement and an incentive for financial institutions to make loans to small businesses that otherwise would not be eligible for such financing.
- **California Welcome Centers.** California Welcome Centers are visitor information centers that are readily accessible to and recognizable by tourists to encourage tourism in California and provide benefits to the state economy. The objective of the California Welcome Center Program is to determine the locality of underserved travelers, designate a welcome center, and establish operating standards across the network.
- **Community Reinvestment Grants Program.** The California Community Reinvestment Grants Program (CalCRG) was established on July 1, 2018, to implement the competitive grant program mandated by Proposition 64, the Adult Use of Marijuana Act, and the provisions specified in Revenue and Taxation Code Section 34019(d). The CalCRG administers grants for local public health departments and qualified community-based nonprofit organizations to support various mental health treatment, substance use treatment, job placement, legal services and other health and wellness-related programs for communities disproportionately affected by past federal and state drug policies in California. GO-Biz must award grants annually and at least 50 percent of the grant funding will be allocated to qualified community-based nonprofit organizations.

Budget. The budget includes \$70.2 million (\$33.4 million General Fund) and 99.3 positions in 2019-20 to support the office and its programs. The following chart from the Governor's budget displays prior year, current year, and budget year positions and expenditures.

3-YEAR EXPENDITURES AND POSITIONS

		Positions			Expenditures		
		2017-18	2018-19	2019-20	2017-18*	2018-19*	2019-20*
0220	Go-Biz	28.8	38.7	41.7	\$5,312	\$7,733	\$7,873
0225	California Business Investment Services	8.1	7.2	12.2	1,773	2,238	2,773
0230	Office of the Small Business Advocate	2.9	2.7	2.7	3,312	23,329	20,330
0235	Infrastructure, Finance and Economic Development	39.8	35.7	35.7	8,373	18,218	19,219
0240	Community Reinvestment Grants Program	-	3.0	7.0	-	10,000	20,000
TOTALS, POSITIONS AND EXPENDITURES (All Programs)		79.6	87.3	99.3	\$18,770	\$61,518	\$70,195

Issue 5: Local Economic Development Liaison Services (SB 635)

Governor's Budget. The Governor's budget requests \$148,000 in General Fund and a Staff Services Manager I position in 2019-20 and ongoing to address geographically targeted economic development areas as required by SB 635 (Hueso), Chapter 888, Statutes of 2018.

Background. Existing law requires GO-Biz to serve as the lead entity for economic strategy and the marketing of California on issues relating to business development, private sector investment, and economic growth. GO-Biz offers a range of services to business owners and prospective owners including: attraction, retention and expansion services, site selection, permit assistance, clearing of regulatory hurdles, small business assistance, international trade development, and assistance with state government.

SB 635 requires GO-Biz to take on two primary activities related to Opportunity Zones (OZs) and Promise Zones (PZs). First, GO-Biz is required to develop informational materials and digital content about location based and other geographically targeted economic development programs, with the intent of the statute pointing to a focus on OZs and PZs. Next, GO-Biz is required to convene, at least annually, representatives from various programs and agencies across the state and from various programs and agencies to discuss how California can leverage PZs and OZs to meet state and local economic development needs.

SB 635 further outlines some of the specific information that must be made available by GO-Biz, including how the local jurisdictions or census tracts were selected, where local jurisdictions and investors can get additional information, and updates about federal programs as they are issued. SB 635 also outlines the topics that must be reviewed in the annual meetings of stakeholders including discussions on enhanced engagement opportunities and targeted outreach to assist designated areas in their efforts to access state resources and services.

PZs are high poverty communities designated by the federal government to increase economic activity, improve educational opportunities, leverage private investment, reduce violent crime, enhance public health and address other priorities identified by the community. Through three rounds of national

competition, 22 urban, rural, and tribal PZs were selected with applicants demonstrating a consensus vision for their community and its residents, the capacity to carry it out, and a shared commitment to specific, measurable results. There are four PZs in California: South Los Angeles, San Diego, Los Angeles, and Sacramento. PZ designees have received:

- An opportunity to engage five AmeriCorps VISTA members in the PZ's work,
- A federal liaison assigned to help designees navigate federal programs,
- Preferences for certain competitive federal grant programs and technical assistance from participating federal agencies, and
- PZ tax incentives, if enacted by Congress (None have been enacted to date).

The package of assistance is meant to accelerate local efforts to drive investments to high poverty communities. During the 10-year term of the designation, the specific benefits made available to PZs will vary from year to year, and sometimes more often than annually, due to changes in the agency policies and changes in appropriations and authorizations for relevant programs.

OZs are federally designated economically-distressed communities (census tracts) where new investments may, under certain circumstances, be eligible for preferential tax treatment. OZs are eligible by either having a poverty rate of at least 20 percent or a median family income that does not exceed 80 percent of the statewide median income. Nearly nine-thousand OZs were selected in April of this year in every state, district, and territory, with 879 of them in California (over 3,500 were eligible to be nominated). The California Department of Finance coordinated the Administration's recommendation of the 879 census tracts to the U.S. Department of Treasury in March 2018. Investors at risk of tax liability from capital gains earned from a previous investment can elect to defer tax liability from capital gains by reinvesting gains into a Qualified Opportunity Fund. Investments made by a Qualified Opportunity Fund into an OZ allow investors to benefit through:

- A temporary tax deferral until December 31, 2026,
- A tax reduction, and
 - By holding investments in a Qualified Opportunity Fund for a minimum of 5 years, the investor's gains will be taxed at a reduced rate of 90 percent
 - By holding investments in a Qualified Opportunity Fund for a minimum of 7 years, the investor's gains will be taxed at a reduced rate of 85 percent
- A tax exclusion (tax-free earnings) after 10 years—all gains accrued on an investor's Opportunity Fund investment during the ten-year period are permanently excluded from taxable gross income.

Staff Recommendation. Approve as budgeted.

0840 STATE CONTROLLER'S OFFICE

Overview. The State Controller is the chief fiscal officer of California, the fifth largest economy in the world. Principally responsible for transparency and accountability of the state's financial resources, the Controller ensures the appropriate disbursement and tracking of taxpayer dollars. The Controller serves on dozens of state boards, commissions, and committees with duties ranging from administrative oversight of the nation's two largest public pension funds, to protection of state lands and coastlines, to modernization and financing of major infrastructure. The Controller also offers fiscal guidance to local governments and has independent auditing authority over government agencies related to the spending of state funds. The Controller's primary objectives are to:

- Account for and control disbursement of all state funds, issuing warrants in payment of the state's bills, including lottery prizes.
- Determine legality and accuracy of financial claims against the state.
- Audit state and local government programs.
- Safeguard many types of assets until claimed by the rightful owners, in accordance with the Unclaimed Property Law.
- Inform the public of the state's financial condition.
- Inform the public of financial transactions of city, county, and other local governments.
- Administer the Uniform State Payroll System.
- Audit and process all personnel and payroll transactions for state civil service, state exempt employees, state university employees, and college system employees.

The Controller's Office includes the following divisions and major projects:

- **Executive Office.** Provides the policy and operational priorities for the State Controller's Office (SCO). Agency functions are coordinated by the chief of staff with support from the chief operating officer and chief administrative officer. Further leadership and policy advice is provided by the chief legal counsel and deputy controllers responsible for legislative affairs, public affairs, investments and financial management, environmental policy, health and housing policy, and taxation policy. The Executive Office also includes Human Resources, Equal Employment Opportunity/Disability Office, and Management Audit and Review Services (an internal auditor function, which exists in most government agencies).
- **Administration and Disbursements Division.** Produces the warrants (printed checks) and electronic fund transfers from the State Treasury, annually issuing about 49 million payments including state payroll, retirement rolls, Medi-Cal, personal income tax refunds, and payments to vendors. Provides staff support services to SCO including budgeting, accounting, contracting, training, procurement, and facilities management.
- **Division of Audits.** Responsible for auditing all funds disbursed by the state and all claims presented to SCO for payment. Performs independent audits of government agencies that spend state funds. Assures the accuracy of local government claims and financial statements submitted to the state and federal government by annually reviewing and revising audit guidelines, reviewing audits performed by independent local auditors

under these guidelines, and performing field audits of state and federal programs. Assists and advises local government officials in effective and uniform tax collecting procedures and internal fiscal controls. Audits highway users' tax funds at local levels, and the allocation and apportionment of local property taxes.

- **Information Systems Division.** Ensures the integrity and security of SCO technology, employees, and facilities. Supports SCO mainframe, public website, and payroll systems with application development, desktop support, and project management oversight.

Budget. The Governor's budget includes \$229.2 million, including \$71.1 million General Fund, \$63.5 million in reimbursements, and \$43.2 million from the Unclaimed Property Fund, to support the department and its various programs. The following chart from the Governor's budget displays prior year, current year, and budget year positions and expenditures.

3-YEAR EXPENDITURES AND POSITIONS

		Positions			Expenditures		
		2017-18	2018-19	2019-20	2017-18*	2018-19*	2019-20*
0500100	Accounting and Reporting	278.4	277.8	277.8	\$46,725	\$54,367	\$55,168
0500200	Audits	264.3	282.7	303.7	47,067	55,746	54,674
0500300	Personnel/Payroll Services	215.4	244.0	233.0	43,275	52,354	48,186
0500400	Unclaimed Property	250.4	255.8	255.8	39,091	41,066	40,068
0500500	Disbursements	80.6	95.8	95.8	27,148	30,860	30,826
0500900	Departmental Administration	-	301.8	305.8	-	277	277
9900100	Administration	319.1	-	-	57,260	-	-
9900200	Administration - Distributed	-	-	-	-57,260	-	-
TOTALS, POSITIONS AND EXPENDITURES (All Programs)		1,408.2	1,457.9	1,471.9	\$203,306	\$234,670	\$229,199

Issue 6: CCURE Upgrade and ACA Reporting

Governor's Budget. The Governor's budget requests \$835,000 (\$687,000 General Fund and \$148,000 Unclaimed Property Fund) in 2019-20, and \$169,000 (\$163,000 General Fund and \$6,000 Unclaimed Property Fund) in 2020-21 and ongoing for the replacement of the Computer Coordinated Universal Retrieval Entry (CCURE) security system. This request also includes one position for increased workload related to the development of the Personnel Payroll Services Division (PPSD) Affordable Care Act (ACA) Reporting System.

Background. CCURE Security System Upgrade. SCO and the State of California have adopted the National Institute of Standards and Technology (NIST) Special Publication (SP) 800-53 as minimum information security control requirements to support implementation and compliance with state and federal mandates. NIST is part of the U.S. Department of Commerce, which provides standards, guidelines and other useful security related information organizations can use to assess their security posture. NIST SP 800-53 provides specific guidance in a broad range of areas including risk assessment, continuous monitoring, security management, access controls, configuration management, contingency planning, incident response, and more. The adoption of NIST standards in 2008 was primarily motivated by the increasing sophistication and frequency of cyberattacks. Ultimately, these controls are contributing to hardening systems against cyber-attacks and other malicious threats.

SCO Information Security Office (ISO) employs a security program framework that follows NIST standards and requires the organization to use concentric levels of control and protection to provide progressively enhanced levels of physical security. To achieve this, ISO deploys a Physical Access Control System (PACS), CCURE 800. PACS devices are used for controlling access and monitoring building entrances, sensitive areas, mission critical asset areas, and alarm conditions from an access control perspective. This includes maintaining control over defined areas such as data sensitive areas, site access points, parking lot areas, building perimeters, and interior areas that are monitored from a centralized security system. ISO's existing security system (CCURE 800) has reached its end-of-life for product software support, necessitating a one-time upgrade to the newest version of the centralized security system (CCURE 9000). This level of security is aligned with the industry's best practice for mission critical security and safety protections for people, buildings, and assets. The existing workload to administer physical security control administration would remain consistent on an on-going workload basis.

PPSD ACA Reporting System. The healthcare law, known formally as the Patient Protection and Affordable Care Act, was initially signed into law in March 2010, with various amendments occurring over the subsequent years. On July 2, 2013, the federal government issued a notice acknowledging the complexity of the legislation and their delay in publishing rules under sections 6055 and 6056 of the Internal Revenue code, as amended by the ACA, to implement employer and insurer reporting requirements for all medium and large employers, such as the State of California.

Due to the complexity of ACA implementation, the Internal Revenue Service (IRS) issued notice 2013-045 providing transition relief to large employers (those with 50 or more employees) for calendar year 2014. This delayed the implementation of the mandated employer shared responsibility provisions until January 1, 2015, and the mandated reporting requirements until January 2016. In June 2015, the IRS issued an "early look" draft for electronically filling the mandated reports required of applicable large employers (forms 1094-C and 1095-C) and the United States Supreme Court upheld key provisions of the ACA in relation to the taxpayer subsidy. This decision allowed implementation of the ACA to proceed. In July 2015, the Trade Preferences Extension Act of 2015 was signed into law. This legislation doubled many of the financial penalties (particularly in the area of reporting) contained within the ACA legislation.

Through a 2016-17 BCP, SCO received funding for PPSD to collaborate with the Information Systems Division (ISD) to design, build, and implement a system to create the 1094-C and 1095-C data that is submitted to the IRS on an annual basis. ISD workload covered under that BCP included development of an ACA mainframe system to interface with SCO's current Payroll and Employment History mainframe systems to obtain reporting data. The actual 1095-C reporting system was developed with web-based technologies using data from the new ACA mainframe system, to take advantage of modern file transmission techniques on a non-mainframe platform. The 2016-17 BCP request did not anticipate this additional workload and an ISD technical resource was redirected to develop the ACA IRS 1095-C reporting system. Ongoing maintenance of the web-based solution was expected to be minimal resulting in SCO not requesting an ongoing resource to support the PPSD ACA Reporting system in the 2018-19 PPSD Workload BCP. However, this proved to be incorrect, as unexpected errors in the 2016 and 2017 1095-C transmissions were detected by the IRS. ISD was not aware until 2018, that unanticipated programming changes to the ACA IRS 1095-C reporting system would be needed.

SCO has determined the ACA reporting cycles are an ongoing workload and is therefore requesting the necessary permanent resource for the non-mainframe report system. The associated system enhancements will grow, as new correction functionality is added and 1095-C correction files need to be transmitted to the IRS on a regular basis.

Staff Recommendation. Approve as budgeted.

Issue 7: Unclaimed Property (UCP) Holder Compliance Audits

Governor's Budget. The Governor's budget requests \$1.6 million from the Unclaimed Property Fund in 2019-20 and ongoing and 11 positions to perform audits of holders to ensure compliance with the California Unclaimed Property Law (UPL), reunite unclaimed property with its rightful owners or heirs, and provide administrative support.

Background. Under California's Constitution and Government Code (GC) section 12410, the State Controller is responsible for auditing all claims made against the State Treasury. GC 12410 states that "the Controller may audit the disbursement of any state money for correctness, legality, and sufficient provisions of law for payment." In addition, the State Controller may conduct a field audit if, in the opinion of the State Controller, such is warranted to protect and preserve taxpayer funds.

The SCO Division of Audits (Audits) acts as an oversight agency for audits of state or local government agencies and performs pre-payment (claim) audits, field audits, special reviews, and investigations, as well as audits of "pass-through" federal funds received by the State for allocation and disbursement to local government agencies. These objectives are accomplished under statutory mandates and through interagency agreements with other state departments, local governments, or the federal government.

The UPL was enacted to ensure that unclaimed property is returned to its rightful owners or heirs, and to prevent holders of unclaimed property from treating that property as business income. By law, holders of unclaimed property must report and remit unclaimed property to SCO after a designated period of time. SCO is a single point of contact for California citizens searching for unclaimed property reported by holders nationwide.

In 2007, Senate Bill 86 (Committee on Budget and Fiscal Review), Chapter 179, Statutes of 2007, modified Code of Civil Procedure Section 1501.5, requiring SCO to improve the reporting procedures for unclaimed property holders in California. This process requires holders of unclaimed property to submit Holder Notice Reports before remitting property to SCO; SCO uses the Holder Notice Reports to send Pre-Eschat Notices to rightful owners. The notices advise owners to contact holders directly to retrieve the reported property, giving the holders an opportunity to reestablish contact with the owners and return their property. After filing the Holder Notice Reports, holders are required to submit Holder Remit Reports to SCO, providing information about property that was not returned. When the Holder Remit Report is filed, holders are required to remit the property to SCO.

The trend in compliance with the Unclaimed Property Law is declining among holders. An SCO analysis identified 16,555 unclaimed property reports were received out of the 1,319,928 active California-based businesses in 2016. This reveals a minimum compliance rate of 1.25 percent. In comparison with prior fiscal years, 2.3 percent in 2013 and 2.2 percent in 2015, the trend in compliance

is declining. Without the requested resources, the trend in compliance with the UPL will continue to decline, which will result in more Californians losing their properties, and reduced revenues to the State's General Fund in the form of penalty interest.

Legislative Analyst's Office (LAO). The LAO recently published a report in which they found that each year, the state receives unclaimed property from holders and reunites some portion of this property with its rightful owners. However, the value of property remitted to the state always exceeds the value of property reunited with owners. This difference provides a monetary benefit to the state, which first is deposited into the Unclaimed Property Fund and then transferred to the General Fund. The state uses the unclaimed property fund to finance SCO's administrative costs to operate the program. The remainder—the amount that is not reunited with owners or used for unclaimed property administration—provides a source of General Fund revenue. This money is spent on programs throughout the General Fund budget.

The LAO agrees with the Governor's goal to increase holder compliance. They cite that, compliance with unclaimed property law is very low. The state has the incentive to increase holder compliance for two main reasons: (1) to result in more property being reunited with owners (both directly by holders as well as by the state), and (2) to increase a source of state revenue.

They found that the threat of a potential audit is an important incentive for businesses to comply with unclaimed property law. That said, while there are benefits to auditing holders—and the General Fund benefit of the audits exceeds the cost of conducting them—there also are clear limitations. Namely, the scale of audits cannot address the vast holder under-compliance rate. With only a couple of dozen audits conducted each year, SCO cannot change the behavior of the hundreds of thousands of California businesses that are not complying with unclaimed property law. As such, this approach is unlikely to result in much additional compliance relative to current trends. The LAO presents the following options:

1. **Include an Unclaimed Property Question on Businesses' Tax Forms.** Most California businesses file income tax returns with the Franchise Tax Board (FTB) each year. Under one option, the Legislature could amend tax law to require businesses to respond to a question about unclaimed property as part of their tax filings. This addition to tax forms could be relatively simple with a single question. For example, the tax form could ask: "Did your business submit a holder notice report to the California State Controller's Office last year?" and indicate that the business could be out of compliance with existing law if it responds "no." Alternatively, the tax form could include a few different questions that ask about different property types and length of time since owner contact. The adoption of this question in tax software would be critical to its effectiveness in improving compliance because so many businesses file their taxes electronically.
2. **Provide a One-Time Amnesty for Noncompliant Holders.** Another option is to provide a one-time amnesty for holders who voluntarily report past-due unclaimed property. Under current law, these holders owe an interest penalty of 12 percent per year for past-due unclaimed property. This may deter some holders from becoming fully compliant, particularly because the probability of being audited is relatively low. The Legislature could temporarily waive this penalty for a certain period for holders who voluntarily report past-due unclaimed property.

Staff Recommendation. Hold open.

Issue 8: Prompt Payment Act Trailer Bill Language

Governor's Budget. The Governor's budget includes trailer bill language to make the Department of FISCAL responsible for applicable penalties if the FISCAL system delays the delivery of a correct claim from a state agency to the Controller.

Background. The Administration is proposing changes to existing language within the Prompt Payment Act in order to align it with the state's new business processes as a result of the deployment of the FISCAL system. The proposed changes would change the wording from "claim schedule" to "claim" to allow for the inclusion of FISCAL vouchers and paper claims. For FISCAL departments, individual payment vouchers are submitted in the system and workflow to claim audits. The claim schedule process has not gone away and will not until full implementation of the FISCAL system. Even after full implementation, there are a number of exempt and deferred departments that will continue to send claim schedules for payment through either the manual "paper" or electronic claims process. Additionally, Departments have the option to submit a paper claim in the event the FISCAL system is not processing their claim timely.

This trailer bill also proposes to add GC 927.7(b) because SCO is no longer the sole entity (outside of departments) responsible for ensuring a claim is paid timely. With the implementation of the FISCAL system, the Department of FISCAL now becomes a responsible party. SCO is seeking this code modification sooner rather than later because of recent system caused delays in the processing of FISCAL claims that both the SCO and departments have experienced. At this time, they are not aware that the time allotment for issuing pay (30 days for departments and 15 days for SCO) has exceeded or been impacted, however should it occur the language will accurately reflect the entities that bear responsibility.

Staff Recommendation. Approve as budgeted.

1701 DEPARTMENT OF BUSINESS OVERSIGHT

Overview. The Department of Business Oversight (DBO) serves 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. Following are the programs within DBO's budget:

- **Investment Program.** The objective of this program is to protect investors in securities and franchise investment transactions and to promote capital formation in California. The program regulates the offer and sale of certain securities, franchises, and licenses and examines broker-dealers and investment advisers.
- **Lender-Fiduciary Program.** The objective of this program is to protect consumers who borrow and enter into financial transactions with lenders and fiduciaries licensed by the Department. The program licenses and regulates businesses engaged in financial transactions such as mortgage loan originators, finance lenders, escrow agents, deferred deposit originators, bill payers, proraters, securities depositories, and property assessed clean energy programs.
- **Licensing and Supervision of Banks and Trust Companies.** The objective of this program is to promote the integrity and stability of state-licensed banks and trust companies, student loan servicing, state-licensed business and industrial development corporations, and state-licensed industrial banks and premium finance companies. This objective is achieved through the regulation, supervision and examination of these institutions, which helps to ensure their safe and sound operation and compliance with laws and regulations.
- **Money Transmitters.** The objective of this program is to promote the integrity and stability of businesses that receive money for transmission, and sell or issue payment instruments and stored value. This objective is achieved through the regulation, supervision and examination of these institutions, which helps to ensure their safe and sound operation and compliance with laws and regulations.
- **Administration of Local Agency Security.** The objective of this program is to monitor the amount and quality of collateral pledged in compliance with law to secure deposits of public funds held by banks, savings and loans, industrial banks, credit unions, and federally chartered financial institutions.
- **Credit Unions.** The objective of this program is to promote the integrity and stability of state licensed credit unions. This objective is achieved through the regulation, supervision and examination of these institutions, which helps to ensure their safe and sound operation and compliance with laws and regulations.

Budget. The Governor's budget includes \$103.5 million to support the Department and its various programs. Major sources of funding for the Department include the State Corporations Fund (\$58 million), the Financial Institutions Fund (\$32.6 million), and the Credit Union Fund (\$10.9 million). The following chart from the Governor's budget displays prior year, current year, and budget year positions and expenditures.

3-YEAR EXPENDITURES AND POSITIONS

	Positions			Expenditures		
	2017-18	2018-19	2019-20	2017-18*	2018-19*	2019-20*
1510 Investment Program	165.7	178.3	179.3	\$27,614	\$32,337	\$32,295
1515 Lender-Fiduciary Program	143.0	134.7	143.7	23,595	24,235	25,792
1520 Licensing and Supervision of Banks and Trust Companies	169.7	171.0	171.0	27,047	28,966	28,207
1525 Money Transmitters	32.6	31.3	31.3	4,282	4,552	5,307
1545 Administration of Local Agency Security	2.0	1.8	1.8	480	581	582
1550 Credit Unions	67.4	67.9	67.9	10,158	11,285	11,299
TOTALS, POSITIONS AND EXPENDITURES (All Programs)	580.4	585.0	595.0	\$93,176	\$101,956	\$103,482

Issue 9: Pilot Program for Increased Access to Responsible Small Dollar Loans (AB 237)

Governor's Budget. The Governor's budget requests \$340,000 State Corporations Fund in 2019-20 and \$320,000 ongoing for two Corporation Examiner positions to examine registered Pilot Program finders at least once every 24 months as required by AB 237 (Gonzalez-Fletcher), Chapter 1016, Statutes of 2018.

Background. In 2009, almost 12 million short-term loans were made under the California Deferred Deposit Transaction Law (California's payday loan law). During that same period, only 167,265 loans were made under \$2,500 under the California Financing Law (CFL). This information suggested a demand for small dollar loans that was not being met under the CFL. This data also showed that consumers were taking out multiple payday transactions and taking out an average of over eight transactions in a twelve-month period.

In 2010, to address California's shortage of affordable loans, the Legislature first established a pilot program named the Pilot Program for Affordable Credit Building Opportunities. CFL lenders approved by the Commissioner to participate in the Pilot Program were authorized to charge higher interest rates and fees on loans from \$300 to \$2,500.

Pilot Program lenders are authorized to use "finders." Finders as defined in statute are unlicensed companies authorized to act on the Pilot Program lenders' behalf. Under the CFL, these finders are required to be licensed as finance brokers. However, licensure is not required for Pilot Program finders. Therefore, under the Pilot Program, the Department only licenses the Pilot Program lender and not the finder.

SB 318 (Hill), Chapter 467, Statutes of 2013, replaced the original Pilot Program (the Pilot Program for Affordable Credit Building Opportunities) with the Pilot Program for Increased Access to Responsible Small Dollar Loans, which is the Pilot Program under current law. The Pilot Program's purpose is the

same as the original Pilot Program - to increase consumer access to small-dollar loans. The Pilot Program retained several aspects of the original Pilot Program, including the use of unlicensed finders. The sunset date of the Pilot Program was extended to January 1, 2018.

SB 235 (Block), Chapter 505, Statutes of 2015, was enacted to expand the activities in which Pilot Program finders could engage on behalf of the Pilot Program lenders and increased the amount Pilot Program lenders could pay the finders.

SB 984 (Hueso), Chapter 480, Statutes of 2016, extended the sunset date of the Pilot Program to January 1, 2023, which is the current sunset date of the Pilot Program. This bill also required the Commissioner to post to the Department website a composite report annually from 2017 to 2021.

Finally, AB 237 expanded the Pilot Program and made changes to the Department's administration of the program. Specifically, the bill: 1) required the Department to examine each finder used by a Pilot Program licensee at least once every 24 months, 2) authorized the Department to charge a Pilot Program licensee that uses one or more finders a fee to offset the costs of finder examinations, 3) increased Pilot Program licensees' reporting requirements to include specific information on each finder whose services were used, 4) increased the maximum permissible loan amount from \$2,500 to \$7,500 and established a debt-to income cap of 36 percent of the borrower's monthly income for a loan greater than \$2,500, 5) required Pilot Program licensees to perform reasonable background checks on their finders, and 6) required Pilot Program licensees to reduce the interest rate on loans made to borrowers who obtain subsequent loans and meet certain requirements.

Staff Recommendation. Approve as budgeted.

Issue 10: California Financing Law License Amendment Processing

Governor's Budget. The Governor's budget requests \$330,000 from the State Corporation Fund in 2019-20 and \$311,000 ongoing for one Corporation Examiner and one Associate Government Program Analyst position to process California Financing Law (CFL) license amendments.

Background. The Department is responsible for the administration of the CFL, which is contained in Division 9 of the California Financial Code, commencing with Section 22000. The CFL requires licensing and regulation of finance lenders and brokers making and brokering consumer and commercial loans, except as specified. The CFL prohibits misrepresentations, fraudulent and deceptive acts in making and brokering loans.

CFL licensees include companies that make installment loans to consumers and to borrowers who need funds quickly for emergencies; non-profit organizations that offer loans at reasonable rates to borrowers to open their own businesses or repair their credit; individuals who act as brokers; and companies seeking licenses under the Property Assessed Clean Energy program.

As of June 30, 2017, there were 2,963 licensed companies operating 6,521 licensed locations. During 2017, CFL licensees reported making over 2.4 million consumer and commercial loans totaling approximately \$194 billion.

The CFL requires licensees to file notifications with the Department when they want to amend a license. License amendment notifications are required to change addresses, names, officers, directors, branch managers, authority, and surrenders. An amended license must be issued to verify that the licensee is authorized to do business at a new location or in a manner that it was not originally licensed for. Delays in processing these requests affect the licensee's ability to conduct business in the manner they feel is most advantageous to their business.

Processing name changes timely is important to borrowers as well as lenders. Lenders may not make a loan involving a broker using an unauthorized name, which can delay the closing of the loan or cause the broker to be in violation for using an unapproved name. Delays in processing address changes can result in companies having their licenses revoked because mail from the Department is sent using an old address and the license is revoked for lack of response. Actions that were initiated with non-current information must be reversed. Reversals result in additional work for the Department.

Approved amendments, including name and address changes, are updated on the Department's website. Borrowers and others use the Department's website to confirm licensee information and to confirm the company they are contracting with is properly licensed. The Department and other interested parties, such as consumers and consumer advocates, need to know where and how CFL licensees are operating. The CFL Amendments Section of the Department is responsible for processing license amendments and reinstatement requests. Currently, the Section consists of three staff: one Corporation Examiner IV and two Corporation Examiners. From 2014-15 to 2015-16, the number of licensees increased by 22 percent, from 2,357 to 2,879; and the number of locations increased by 19 percent, from 5,318 to 6,328. The sudden steep increase in CFL licensees within one year resulted in a significant backlog in the amendments processing unit. The Section did not track the number of amendments processed by year until 2017-18. The backlog of amendments to be processed as of June 21, 2018 was 616.

Staff Recommendation. Approve as budgeted.

Issue 11: California Residential Mortgage Lending Act – Examination Cycle

Governor's Budget. The Governor's budget requests \$854,000 from the State Corporations Fund in 2019-20 and \$804,000 ongoing for five Corporation Examiner positions to carry out the regulatory requirement to examine California Residential Mortgage Lending Act (CRMLA) licensees and California Financing Law (CFL) licensees that conduct residential mortgage activities.

Background. The economy experienced a serious downturn between 2008 and 2012. The real estate industry was hit especially hard. The residential housing market experienced significant reductions in market value and consumers were faced with mortgages exceeding the value of their homes, difficulties in maintaining mortgage payments necessary to keep their homes, and often the inability to modify, refinance, or even sell their homes.

The economic downturn and the increased number of foreclosures motivated federal and state legislators to issue new federal and state laws and regulations to strengthen protections afforded homeowners in California and the nation. The Secure and Fair Enforcement for Mortgage Licensing (SAFE) Act was enacted on July 30, 2008 and established minimum standards for individual states to license and register residential mortgage loan originators. The federal Consumer Financial Protection

Bureau issued the Ability to Repay and Qualified Mortgage Standards regulation to strengthen the Truth in Lending Act by prohibiting a creditor from making a higher-priced mortgage loan without regard to the consumer's ability to repay the loan. The California Homeowner Bill of Rights became law on January 1, 2013 to ensure fair lending and borrowing practices for California homeowners. The Due Process and California Foreclosure Reduction Act became law on January 1, 2013 to protect California homeowners from inadvertent foreclosure while applying for a loan modification.

The CRMLA authorizes licensees to make and service residential mortgage loans secured by properties with one to four family residences. The Department issues licenses under the CRMLA to companies that meet the requirement to be a residential mortgage lender, mortgage loan servicer or both.

A lender directly makes the loan, makes the credit decision in the loan transaction and uses its own funds, including warehouse lines of credit, to fund the loan. A mortgage loan servicer collects mortgage loan payments from borrowers. Mortgage payments include principal, interest and amounts placed in escrow for payment of property taxes, hazard insurance, mortgage insurance premium and other expenses.

As stated in California Financial Code Section 50302 (a), the CRMLA requires the Department to examine each CRMLA licensee at least once every 48 months, or more often as the commissioner deems necessary and appropriate. The Department currently has 418 licensees that must be examined at least once every four years. Licensees with a history of noncompliance with the CRMLA may be examined more often.

The Department also regulates residential mortgage lenders and servicers under the CFL. Under California Financial Code Division 9, Section 22701 (a) regulating CFL licensees, the commissioner may at any time examine a CFL licensee to discover violations or secure information to administer and enforce the division. To maintain Department accreditation with the Conference of State Bank Supervisors, Department standards require the examination of each CFL licensee conducting mortgage activities at least once every 60 months.

Staff Recommendation. Approve as budgeted.