

# Report of the Joint Committee on Fiduciary Financial Institutions Oversight to the 2023 Kansas Legislature

**CHAIRPERSON:** Senator Jeff Longbine

**VICE-CHAIRPERSON:** Representative Jim Kelly

**OTHER MEMBERS:** Senators Michael Fagg, Ty Masterson, and Jeff Pittman; and Representatives Nick Hoheisel, Dan Osman, Stephen Owens, and Rui Xu

**CHARGE**

*Monitor and Make Recommendations on Fiduciary Financial Institutions in Kansas*

Pursuant to KSA 46-4001, the Committee is directed to monitor, review, and make recommendations regarding fiduciary financial institutions' operations in the state of Kansas and the fiduciary financial institutions pilot program, and to receive a report from the Office of the State Bank Commissioner.



# Joint Committee on Fiduciary Financial Institutions Oversight

## ANNUAL REPORT

### Conclusions and Recommendations

The Joint Committee on Fiduciary Financial Institutions Oversight submits the following comments and recommendations:

- **Amendments to the Technology-enabled Fiduciary Financial Institutions (TEFFI) Act and related provisions addressing charitable organizations.** The Committee acknowledges its receipt, consideration, and recommendation of these two requested proposals for legislation:
  - The first addresses the inability of the Office of the State Bank Commissioner (OSBC) to obtain background checks from the Federal Bureau of Investigation. The proposal would add definitions to KSA 9-2301 to define certain officials within the fiduciary financial institution subject to the background check (under KSA 9-2302, which would be amended to require, rather than permit, fingerprinting of such officials). [Requested by OSBC]
  - The second addresses expansion of the definition of “charitable beneficiaries” within the TEFFI Act (KSA 9-2301(b)(4) and KSA 79-32,283) regarding an income tax credit for certain qualified charitable distributions of fiduciary financial institutions. [Requested by Beneficient]
- **Progress report to the Legislature, review of the standing committees on financial institutions.** The Committee directs its report to the standing committees of the Kansas Legislature for possible oversight during the 2023 Session. These committees are requested to review and consider any requested changes relevant to the findings associated with the ongoing examination of Beneficient, and the Committee requests both the regulatory agency (OSBC) and the participating fiduciary financial institution submit to those standing committees any changes to the TEFFI Act deemed necessary to continue and enhance oversight and conduct of fiduciary financial institution operations in Kansas.
  - Additionally, the Committee recognizes the completion of the application process for the Beneficient Company Group, LP; the State Banking Board’s recognition of issuance of the permanent charter on December 31, 2021, commencement of fidfin transactions, and conclusion of the FidFin Pilot Program; and the ongoing working relationship and information gained as a result of the two initial examinations (IT, Bank Secrecy Act) and the progress on a compliance examination. Such information will be necessary to formulate any future regulation to ensure the ongoing oversight of fiduciary financial institutions in Kansas.

**Proposed Legislation:** Two bills (background checks; charitable organizations).

## BACKGROUND

The Joint Committee on Fiduciary Financial Institutions Oversight (Committee) was established by the enactment of 2021 Senate Sub. for HB 2074, Section 29, codified at KSA 2021 Supp. 46-4001. This nine-member joint committee is required to:

- Monitor, review, and make recommendations regarding fiduciary financial institutions' operations in the state of Kansas;
- Monitor, review, and make recommendations regarding the FidFin Fiduciary Institution Pilot Program (pilot program); and
- Receive a report from the Office of the State Bank Commissioner (OSBC). [*Note:* The bill also required the OSBC to submit an initial report prior to December 31, 2021, that provided an update on the implementation of the Technology-enabled Fiduciary Financial Institutions (TEFFI) Act and pilot program. The bill required this report to include recommendations from the OSBC for any legislation necessary to implement provisions of the TEFFI Act.

The Legislative Coordinating Council authorized the Committee to meet for one day.

## COMMITTEE ACTIVITIES

The Committee met on December 1, 2022, to review 2022 law and legislation regarding fiduciary financial institutions and the oversight assigned to the Committee and receive updates on fiduciary financial institutions operations and activities in the state. Testimony was provided by representatives of the fiduciary financial institution (often referred to as a "TEFFI") by the 2021 law (The Beneficient Company Group, LP [Beneficient]), the regulatory authority authorized by the 2021 law (the State Bank Commissioner [Commissioner] and representatives of the OSBC), and a representative of the Kansas Department of Commerce (Department).

## Overview of Fiduciary Financial Institutions' Legislation and Law—2022 Session

Committee staff from the Kansas Legislative Research Department (KLRD) provided a summary and background information for legislation passed by the 2022 Legislature related to fiduciary financial institutions and also highlighted a concurrent resolution related to the scope of the Committee. The KLRD Assistant Director for Research indicated six bills were considered, and three were advanced to the Governor for consideration (approved):

- **SB 337** – Conversion to a Full Fiduciary Financial Institution Charter. This bill amends provisions pertaining to the pilot program established within the TEFFI Act to clarify and retroactively codify the intended date for the issuance of a full charter to Beneficient. The bill specifies that on December 31, 2021, the conditional charter granted under this pilot program shall be converted to a full fiduciary financial institution charter. [*Note:* The bill incorporates the recommendation and statement of legislative intent regarding issuance of a permanent charter published in this committee's report to the 2022 Legislature.]

Effective Date: Publication in the *Kansas Register* (March 10, 2022);

- **HB 2489** – TEFFI Act Amendments, Required Reporting of Elder Abuse. This bill makes several amendments to the Act pertaining to an updated definition, fingerprinting requirement, existing application fee, governing documents, evaluation and examination, customer disclosure, and services and authorized activities. The bill also amends the definition of "financial institution" within a statute requiring the reporting of abuse, neglect, or exploitation of certain individuals to include fiduciary financial institutions. [*Note:* The bill, as introduced, reflected the draft legislation submitted by the OSBC to this Committee at its December 2021 meeting. The Committee

recommended the draft legislation be introduced by the standing committees on financial institutions during the 2022 Session.]

Effective Date: Publication in the Statute Book (July 1, 2022); and

- **HB 2547** – Captive Insurance Law – TEFFI insurance companies. This bill amends and enacts law supplemental to the Captive Insurance Act to allow a TEFFI insurance company to operate as an authorized captive insurance company in Kansas (to operate as a pure captive). Under the bill, a TEFFI insurance company issued a certificate of authority under this act will be deemed as an “insurance company” under KSA 40-222c and will be subject to the supervision of the Commissioner of Insurance.

Effective Date: Publication in the *Kansas Register* (April 14, 2022).

The KLRD Assistant Director also noted HCR 5034, which would have provided several findings regarding environmental, social, and governance (ESG) standards. The concurrent resolution, if adopted, would have directed the Committee, the resolution’s sponsors, and the State Treasurer, where appropriate, at the Legislature’s direction “to work with concerned parties to study the topic of ESG standards and draft legislation that protects the State of Kansas and its citizens from the use of ESG standards.”

## **Update on Fiduciary Financial Institutions’ Operations in the State of Kansas**

### ***Office of the State Bank Commissioner***

The Commissioner provided an update on the status of the state’s pilot program for TEFFIs and the activities of the authorized participant (Beneficient). The Commissioner was joined by the Deputy Bank Commissioner, who addressed the status of OSBC examinations and the working relationship with Beneficient, and by the OSBC General Counsel, who addressed proposed amendments to the TEFFI Act. Two examiners were also present to address Committee questions.

### ***Resolution of Application Delays***

The Commissioner first addressed the material delays experienced in Beneficient’s application submission, noting the most significant delays were due to the inability of the applicant to provide the required audited financial statements and the OSBC’s inability to obtain background checks conducted by the Federal Bureau of Investigation (FBI) due to the way the TEFFI Act is written. (The Committee received updates on both issues at its December 2021 meeting).

The Commissioner reported the audited financial statements for the periods ending December 31, 2020, December 31, 2021, and March 31, 2022, were delivered by the applicant to the OSBC on October 27, 2022. However, the OSBC had not been able to make any progress with the FBI regarding background checks, so it has relied on alternative checks.

### ***State Banking Board Actions; Application Status; Conclusion of Pilot Program Recognized by Board and OSBC***

The Commissioner noted the State Banking Board (Board), the entity that acts on applications by state-chartered banks and trust companies, recognized that Beneficient’s authority to transact business was enacted by the Kansas Legislature in language essentially granting Beneficient a charter to do business in KSA 9-2325(d)(1). [Note: SB 337, discussed earlier in this report, retroactively codified a full charter as of December 31, 2021; the bill was effective upon its publication in the *Kansas Register* in March 2022.] Consequently, the Commissioner noted, the Board has taken no action on the Beneficient application. He confirmed that both the Board and the OSBC consider this application complete as required by KSA 9-2325(a)(1).

Additional items recognized by the Board regarding the state-granted charter for Beneficient include:

- The Board’s authority to approve or deny Beneficient’s license pursuant to KSA 9-2302 was superseded by Beneficient’s satisfying all conditions of KSA 9-2325(d)(1);

- Beneficiary's charter was granted without review of the financial standing, general business experience and character of Beneficiary's organizers, or the character, qualifications, and experience of Beneficiary's officers; and
- The pilot program has concluded, and the Board has authority to approve or deny any other TEFFI charter applications submitted pursuant to TEFFI Act requirements (KSA 9-2302).

The Commissioner said that as a result of the Board's recognition of the transactional authority granted to Beneficiary by the Legislature and the anticipated conclusion of a third examination (described in the following section), the OSBC considers the provisions of the pilot program will be complete and the pilot program can be concluded. This would permit other TEFFI businesses to apply for a charter in Kansas, the Commissioner stated; and as of this meeting, no inquiries have been made to the OSBC from potential applicants.

The Commissioner also indicated the OSBC continues to monitor business connections and interlocking management between Beneficiary and a former affiliate, GWG Holdings, Inc. The OSBC is following an ongoing federal Securities and Exchange Commission (SEC) investigation and related bankruptcy filing, which will be acted upon if Beneficiary or its principal are adversely impacted.

#### *Examinations; Relationship and Dialogue with Beneficiary*

The Commissioner noted continued concerns regarding the OSBC's ability to conduct meaningful examinations. He particularly noted the limitations in the TEFFI Act that disallow consideration of safety and soundness principles as well as departures from Generally Accepted Accounting Principles (GAAP). (A request regarding examination language is noted in the legislative proposal described later in this section.)

The OSBC has conducted two targeted examinations of Beneficiary in 2022, and a third is scheduled to commence in December 2022. The

Committee noted a pass/fail examination determination finding will serve as the alternative to a safety and soundness examination that determines whether certain standards are met.

The Deputy Bank Commissioner reported the OSBC has completed examinations in the areas of BSA (Bank Secrecy Act) compliance and information technology (IT) to help determine whether industry standards and regulations have been met. Noting examination reports, materials, and ratings are confidential, the Deputy Commissioner indicated he could state that Beneficiary was well-prepared for these examinations and examiners found Beneficiary to be in a position that did not cause any deep concern in these two areas. Examiners appreciated the prompt responses for materials and data requests.

The third examination designed to determine compliance with the TEFFI Act is scheduled to commence with an on-site visit to Beneficiary's office in Hesston on December 19. Materials have been requested and received by examiners to analyze and conduct off-site review; this will allow the on-site review to be more productive and efficient. A visit to Beneficiary's Dallas, Texas office will likely occur in early January 2023.

The Deputy Commissioner indicated due to the uniqueness of the TEFFI business model, there is no anticipated completion date. Going forward, the OSBC plans to treat a TEFFI in a consistent manner as with other financial institutions (the common practice for a *de novo* financial institution is to receive annual examinations for at least the first three years of its operation). Future examination schedules will be dependent on examination findings and the actions of Beneficiary.

The Deputy Commissioner addressed the communications and OSBC/Beneficiary meeting schedule set up to facilitate any current issues of concern and the scheduling of examinations. These conversations have resulted in improved dialogue between the two parties, and the OSBC views this arrangement as beneficial as it continues to develop standards and expectations from the regulated entity (TEFFI) and regulator (OSBC).

## *Proposed Legislation*

The OSBC General Counsel next addressed a proposal to amend two statutes in the TEFFI Act (KSA 9-2301 *et seq.*). He noted the agency's concern and inability to receive background checks on any TEFFI officer, director, or organizer. Despite the inclusion of the changes requested by the FBI in 2022 HB 2489 (law), the FBI has refused to permit the OSBC to submit and receive background checks. The proposed bill would:

- Add definitions to KSA 9-2301 to define an “officer,” “director,” and “organizer.” (These individuals are subject to background checks under KSA 9-2302); and
- Amend KSA 9-2302 to clarify that the Commissioner has the authority to require fingerprinting.

The General Counsel indicated the OSBC, as a customary practice, requests and reviews background checks on behalf of the State Banking Board. As a condition to receive background checks from the FBI, he noted, the OSBC is required to agree not to accept any private entity criminal history record checks. This new language complies with the FBI request and the OSBC will also meet FBI requirements to not disclose criminal history information for any other purpose and to treat background checks as confidential.

## *Discussion*

The Committee and representatives of the OSBC discussed safety and soundness requirements associated with examinations of other financial institutions, with the Commissioner noting the TEFFI Act does not consider intangibles and earnings (generally, “capital”) and TEFFIs do not accept deposits.

Capital, the Commissioner stated, could be eroded without quality earnings and is critical in the determination of safety and soundness (two of six standards typically reviewed relate to capital). The discussion also included proceeding beyond the financial statements provided and how to treat “goodwill” as an intangible asset. The Commissioner responded to a question regarding

alternatives to the FBI background check, noting the FBI check would address any criminal activities, while an alternative check may or may not include these activities (civil record check).

## ***Beneficient Company Group, LP***

The Beneficient Chief Executive Officer (CEO) and Chairman of the Board; President and Chief Fiduciary Officer (CFO); Managing Director and Co-Head, Fiduciary Financial Institutions (Managing Director); and a legal representative from Crossroads Legal Solutions provided an update addressing operating achievements and Economic Growth Zone (EGZ) funding, TEFFI pilot program milestones and legislative proposals, and the planned grocery store and activities in Hesston and a “Go Public” opportunity (*i.e.*, upon closing of a business combination agreement, Beneficient would become a publicly traded company). A Beneficient board member and Beneficient fiduciary financial institutions and accounting staff members also were present at the meeting.

Beneficient representatives submitted two reports for the Committee reference and record: Management report for Beneficient (combined statement of financial position of the Kansas TEFFI Economic Growth Trust and Subsidiary, and Beneficient Heartland Foundation, Inc. and Subsidiary, as of September 20, 2022) and Legislative report for Kansas TEFFI charitable activity (an independent auditor’s report for these consolidated financial statements).

## *Goals and Operational Achievements*

The legal representative first highlighted three goals Beneficient and its officers set for the establishment of TEFFI business in Kansas: through enactment of TEFFI legislation, creating a world-class technology platform for alternative asset liquidity; by the end of calendar year 2022, having over \$250 million invested in TEFFIs in Kansas; and having \$10 to \$15 million generated for rural economic development in the EGZs or going directly to the Department. The representative confirmed Beneficient had met and exceeded these goals, noting for the period of December 31, 2021, through September 30, 2022, an approximate \$255 million has been generated in closed FidFin transactions and a total of \$18.15 million was generated for EGZ contributions

(\$2.92 million to the Department and \$15.23 million to the EGZ and Beneficient Heartland Foundation for the EGZs).

**Technology platform.** The CFO highlighted the technology platform, which he termed a key element of the TEFFI Act (“technology-enabled”). The platform serves as a robust, online transaction processing system, where a customer is able to engage with Beneficient online, transact business, select the kind of liquidity to be received, and submit and close the transaction through the online customer portal. This platform has received a SOC 2, Type 1 report (Security, Availability, and Processing Integrity), which the CFO explained means the platform is built to conform with and meet very high industry standards. Beneficient’s platform also received AT&T NetBond certification. It is anticipated Beneficient’s platform will achieve an SOC Type 2 and SOC 3 report by next June. If these credentials are achieved, the CFO continued, Beneficient would be the only company in the industry with such credentials.

**Economic Growth Zone funding.** The CFO provided an overview of this funding, noting the cash flow for the allocated of the 2.5 percent of FidFin financings through September 30, 2022: Department (\$2.92 million) and Beneficient Heartland Foundation (\$13.61 million). As of September 30, there is \$1.62 million in the Kansas TEFFI Economic Growth Trust (described as “excess funding”). The CFO explained this trust is administered exclusively for the benefit of the EGZs and the Department and it facilitates timely closing of customer financings. In terms of fund management, the trust manages the in-kind asset funding of EGZ contributions and distributes cash flow to the Beneficient Heartland Foundation and the TEFFI Development and Expansion Fund (Fund) of the Department.

The funding associated with this Fund (\$2.92 million) represents \$2.71 million of cash and nearly \$200,000 in monetizing assets. The Department announced a grant program associated with this allocation (detailed later in this report). The CFO also detailed the work of the Foundation, noting it is a Kansas nonprofit corporation and it must commit to using funds exclusively for the benefit of the EGZs (e.g., grocery store financing) or postsecondary educational institutions in

Kansas, must provide an annual report to the Department, and be focused on funding community-led initiatives. Governance of the Foundation is focused on community involvement; 9 of the 13 board of directors are community leaders and the remaining 4 are from Beneficient.

**TEFFI Pilot Program milestones.** The Beneficient Managing Director addressed the following audits and financial data submitted to the OSBC on October 26, 2022:

- Audited financial statement for Beneficient as of December 31, 2021, and the three months ending March 31, 2022;
- Agreed-Upon Procedure report that reconciles Beneficient’s GAAP financials to non-GAAP contractual reporting pursuant to requirements in KSA 9-2307;
- Consolidated audited financial statements for the Beneficient Company Group for the periods of 2019, 2020, 2021, and March 31, 2022; and
- Agreed-Upon Procedure report that reconciles GAAP financials to contractual reporting, adjusting for non-cash and one-time extraordinary expenses.

The Managing Director indicated Beneficient plans to deliver the consolidated audited financial statements for the Beneficient Company Group for the period ending June 30 and September 30, 2022, to the OSBC within the week of the meeting. He also commented on the timelines associated (from the OSBC data request to exam commencement and exam completion) for the two examinations completed with successful results: IT and BSA/ AML/OFAC (Anti-Money Laundering/Office of Foreign Assets Control). The Managing Director outlined the ongoing compliance examination, stating the first document request was received October 18, 2022, the exam will commence on-site in Hesston on December 19, 2022, and the tentative site visit in Dallas is scheduled for January 3, 2023. He commented that Beneficient does not have any issue with the extent of the requests for information.



**Proposed legislation.** The Managing Director noted that Beneficient does not have any proposed legislative changes to what he termed the TEFFI-oriented provisions of the TEFFI Act. He further noted Beneficient recommends a minor modification to expand the definition of “charitable beneficiaries” as provided under KSA 9-2301(b)(4) [TEFFI Act—definitions section] and KSA 79-32,283 [income tax credit for certain qualified charitable distributions of fiduciary financial institutions] to:

- Include one or more charitable organizations designated as beneficiaries of a fidfin trust which are either:
  - (i) charities, contributions to which are allowable as a deduction pursuant to section 170 of the federal Internal Revenue Code; or
  - (ii) one or more of a Kansas nonprofit corporation, regardless of their federal income tax treatment.

**Grocery store initiative and Go Public opportunity.** The CEO reviewed the progress of the initiative in Hesston, noting the Heartland Foundation Task Force is assembled and has weekly planning sessions. In addition, the site for the new grocery store has been identified and announced and a memorandum of understanding has been signed with the grocery store operator. The storefront will resemble the outline of historic buildings from Hesston’s past.

The CEO also addressed Beneficient’s Go Public opportunity with Avalon Acquisition, Inc., a publicly listed, special purpose acquisition company. The business combination agreement for the two companies was announced on September 21, 2022. Upon final closing of this combination, Beneficient will become a publicly traded company. At the time of the Committee meeting, Beneficient was finalizing the S-4 registration statement to be filed with the SEC for review and approval. Speaking to the purpose of “going public,” the CEO noted access to the public markets reduces Beneficient’s cost of capital, and publicly traded stock provides an additional form of currency customers can select in securing liquidity for their alternative assets.

One positive impact highlighted was the potential for high numbers of fidfin transactions, which could expand funding for the EGZ and the TEFFI Development and Expansion Fund.

**Industry interest in TEFFI operations in Kansas.** Representatives of Beneficient submitted and referenced a statement provided by a managing partner with Convergency Partners, an advisory firm in Boston. Convergency indicated it has reviewed and analyzed the TEFFI Act and considered how this act may help the industry in the short and longer term. The letter concluded stating “[o]nce the pilot program concludes and the [OSBC] expresses its willingness to accept applications from additional financial institutions, we will see a variety of industry participants explore the opportunity to establish operations in Kansas and operate under the TEFFI Act.”

#### *Discussion*

The CEO addressed an earlier questions posed to the OSBC regarding intangibles and the comparison with capital earning requirements for financial institutions. He pointed to the KYC (Know Your Customer) process and its applicability to participation in the technology-enabled platform Beneficient maintains (*i.e.*, protections against fraud, corruption, money laundering) and valuation of this platform, which is essential for operations. He noted the changes in the banking economy and reporting Beneficient provided to the OSBC to assist in extracting the “real earnings.”

The Committee and representatives of Beneficient discussed the distinction between “charitable” and “nonprofit” as it related to contributions associated with the TEFFI Act. The Committee also discussed select members participating on the Beneficient Board and the Go Public opportunity.

The representatives and Committee discussed the role of capital and its association with consumer and investor protections. Also addressed were the next steps for a TEFFI insurance company (captive); it was reported funds are in escrow at the holding company level and Beneficient decided to wait until it completed the application/pilot program process with the OSBC. The most immediate step will be discussions with

the Commissioner of Insurance to start the application process. Finally, the Committee and Beneficient representatives discussed the dialogue with the OSBC and lessons learned from examinations to date.

### *Kansas Department of Commerce*

The Director of Legislative Affairs for the Department addressed the requirements in the TEFFI Act that established the Technology-enabled Fiduciary Financial Institutions Development and Expansion Fund (Fund). The Act requires expenditures from the Fund to be used for economic development projects in EGZs in the state and for promoting and facilitating the development and growth of fiduciary financial institutions, fidfin activities, and custodial activities in Kansas and to locate fiduciary financial institutions office space in an economic growth zone.

**SEED.** After receiving funding (the TEFFI Act prescribes the applicable and required distribution amounts and schedules for the Department and Fund), the Department developed a request for application for the Strategic Economic Expansion and Development (SEED) grant program. The program's purpose is to support the economic revitalization of Kansas communities under 5,000 in population (within the 78 counties designated in the Act) through investments in quality-of-life initiatives. Applications were accepted through September 30, 2022. The Department received 109 applications, with a total funding request of \$4.72 million. The Department, as of this committee meeting, had completed the eligibility review and the merit review.

The SEED grant eligibility requirements also were reviewed. Among the requirements, applicants:

- Must be a county or municipal government, economic development organization, local chamber of commerce, library system, or a 501(c)3/ 501(c)6 nonprofit organization;

- Only one application per county will be awarded funding; and

- Cannot have received a BASE (Building a Stronger Economy) or HEAL (Historic Economic Asset Lifeline) grant for the project.

The submitted projects must also fit into one of the following categories: community vibrancy, child care and senior programming, libraries, and food retail. The projects must be completed within 12 months. The eligibility requirements also address the use of funding and provide criteria for instances where funding cannot be used (e.g., to support one-time programming including speaker fees, event fees, or salaries.)

### **CONCLUSIONS AND RECOMMENDATIONS**

Following the presentations and updates, the Committee submits the following comments and recommendations reflecting its discussion:

- **Amendments to the Technology-enabled Fiduciary Financial Institutions Act and related provisions addressing charitable organizations.** The Committee acknowledges its receipt, consideration, and recommendation of these two requested proposals for legislation. (Bills will be pre-filed for introduction to address background check requirements and certain charitable contributions.)
- **Progress Report to the Legislature, Review of the Standing Committees on Financial Institutions.** The Committee directs its report to the standing committees of the Kansas Legislature for possible oversight during the 2023 Session. These standing committees are requested to review and consider any suggested changes to the TEFFI Act and regulatory provisions to ensure ongoing oversight of fiduciary financial institutions.