

Report of the Joint Committee on Fiduciary Financial Institutions Oversight to the 2024 Kansas Legislature

CHAIRPERSON: Representative Nick Hoheisel

VICE-CHAIRPERSON: Senator Jeff Longbine

OTHER MEMBERS: Senators Michael Fagg, Ty Masterson, and Jeff Pittman; and Representatives Dan Osman, Stephen Owens, Laura Williams, 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:

- **Advisory group.** The Committee acknowledges the unique regulatory framework established to monitor Technology-enabled Fiduciary Financial Institutions (TEFFIs) in Kansas. With experience gained from the pilot program, examination cycle, and dialogue among the Committee, the Office of the State Bank Commissioner, the Beneficial Fiduciary Financial, LLC, and the Kansas Department of Commerce, the Committee expresses support for the creation of an advisory council that would add an additional perspective on future regulations and TEFFI activities, alternative assets industry features and standards, and the promotion and marketing activities to help secure potential future investments in Kansas and its communities. The advisory council should also include among its advisors experts familiar with federal regulation and oversight and academia familiar with the industry.

The Committee encourages the formation of this advisory *ad hoc* group and dialogue with both the relevant standing committees of the Legislature and this committee.

The Committee directs its report to the standing committees of the Kansas Legislature charged with the oversight of financial institutions (Senate Committee on Financial Institutions and Insurance and the House Committee on Financial Institutions and Pensions).

Proposed Legislation: None.

BACKGROUND

The Joint Committee on Fiduciary Financial Institutions Oversight was established by the enactment of 2021 Senate Sub. for HB 2074, Section 29, codified at KSA 46-4001. This nine-member 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 during the 2023 Interim.

COMMITTEE ACTIVITIES

The Committee met on November 7, 2023, to review 2023 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 technology-enabled fiduciary financial institution (often referred to as a "TEFFI") recognized by the 2021 law (the Beneficent Company Group, LP [Beneficent or BFF in this report], 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—2023 Session

Committee staff from the Office of Revisor of Statutes provided a summary and background information for legislation considered or passed by the 2023 Legislature related to fiduciary financial institutions and also highlighted a concurrent resolution related to the scope of the Committee. The Senior Assistant Revisor of Statutes indicated six bills were considered, and the following bill was advanced to the Governor for consideration (approved):

- **SB 44** – Enacting the Kansas Financial Institutions Information Security Act. This bill includes TEFFIs, along with other financial institutions, as a "covered entity" to which the act applies. The bill requires covered entities to set forth standards for developing, implementing, and maintaining reasonable safeguards to protect the security, confidentiality, and

integrity of customer information pursuant to federal regulations.

Effective date: Publication in the *Kansas Register* (April 27, 2023).

The revisor also reviewed the following relevant bills receiving legislative consideration during the 2023 Session [current status indicated]:

- **SB 51** – Authorizing the State Bank Commissioner to accept state and national criminal history record checks from private entities (Senate Committee bill, introduced at request of the OSBC). The bill would amend provisions of the TEFFI Act to add the Commissioner to the entities permitted to require fingerprinting of the officers, directors, or organizers of a TEFFI. (current law states that only the State Banking Board is allowed to require fingerprinting.) The bill would also provide that the Board or the Commissioner shall not authorize receipt of a state and national criminal history record check from a private entity unless the Kansas Bureau of Investigation (KBI) or Federal Bureau of Investigation (FBI) is unable to supply such record check. It would also provide that the Board or the Commissioner shall not disclose or use a criminal history record check, except as provided for in the TEFFI Act. [Note: The Senate Financial Institutions and Insurance Committee (Senate Committee) recommended the bill be passed on February 14, 2023; the bill was withdrawn from the Senate Calendar, referred to the Senate Committee on Ways and Means; finally, it was re-referred to the Senate Committee on April 4, 2023.]
- **SB 204** – Replacing the definition of "charitable beneficiaries" with "qualified charities" in the Technology-enabled Fiduciary Financial Institutions [TEFFI Act] (bill title, as amended by Senate Committee). The bill would replace the definition of "charitable beneficiaries" with "qualified charities" in the TEFFI Act. The Senate Committee amendments expanded the definition of "qualified

charities” for purposes of the income tax credit for charitable distributions of fidfin institutions by including one or more Kansas nonprofit corporations, regardless of their federal income tax treatment. [Note: The Senate Committee recommended the bill be passed, as amended on February 15, 2023; the bill was withdrawn from the Senate Calendar, referred to the Senate Committee on Ways and Means; it was then referred to the Committee of the Whole on March 1, 2023. On April 4, 2023, the bill was re-referred to the Senate Committee.]

- *HB 2133* – Providing that fiduciary financial institutions shall be overseen, supervised, and examined by the OSBC as a chartered trust company, allowing a fiduciary financial institution to refer to itself as a trust company in legal or regulatory filings or disclosures to existing or prospective customers or investors, and authorizing a fiduciary financial institution to exercise fiduciary powers and full trust powers and to engage as a trust company under state and federal laws (bill title, as amended by the Senate Committee). The bill, as introduced, pertained to a surcharge on the use of payments with credit or debit cards. As amended, the bill only pertained to fiduciary financial institutions, adding language to the TEFFI Act to provide that a TEFFI shall be overseen, supervised, and examined by the OSBC as a chartered trust company and shall be designated, recognized, and referenced as a chartered trust company by the OSBC. The bill would also add language that a TEFFI is a trust company for all purposes under federal and state law and that a TEFFI shall not be restricted from publishing or promulgating itself as a trust company in legal or regulatory filings or disclosures to existing or prospective customers or investors. The bill would add language to grant TEFFIs the power to exercise fidfin powers and full trust powers and to engage as a trust company in trust business in any manner that assists in the performance of engaging in fidfin transactions and to receive, retain, and manage alternative asset custody

accounts in accordance with the TEFFI Act. [Note: The Senate Committee recommended the bill be passed, as amended on April 5, 2023. The bill remains on the Senate Calendar.]

Other introduced bills and resolution. The revisor noted two additional bills, which have been referred to the Senate Committee: SB 199 (authorizing the Board to deny, suspend, or revoke a charter of a fiduciary financial institution in certain circumstances, requiring fiduciary financial institutions to purchase a surety bond, and establishing a civil money penalty for violations of the TEFFI Act); SB 302 (suspending fidfin transactions, custodial services, and trust business of TEFFIs until the Legislature expressly consents to and approves such activities by an act of the Legislature, and requiring the Legislature to conduct a forensic audit of TEFFIs); and HCR 5014 (directing the Joint Committee on Fiduciary Financial Institutions Oversight to study and draft legislation relating to environmental, social, and governance standards). The Senate bills have been referred to the Senate Committee; the HCR was referred to the House Committee on Financial Institutions and Pensions.

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

Prior to the reports from the regulatory agency and the regulated fiduciary financial institution, the Committee chairperson acknowledged that since the Committee’s December 2022 meeting, Beneficient has become a publicly traded company. It was noted that certain information would be subject to disclosure/ non-disclosure requirements by the federal Securities and Exchange Commission and may not be able to be fully discussed within this committee.

[Note: In the December 2022 meeting, BFF officials addressed a Go Public opportunity with Avalon Acquisition, Inc., a publicly listed, special purpose acquisition company.]

Office of the State Bank Commissioner

The Commissioner provided a report on the regulatory activities conducted by the OSBC regarding the sole TEFFI chartered and existing in Kansas, Beneficient Fiduciary Financial, LLC,

Hesston, Kansas (now known as BFF, LLC). The Commissioner was joined by the Deputy Bank Commissioner and OSBC General Counsel.

Update on Regulatory Activities

Charter; TEFFI Act. The Commissioner acknowledged the first meeting of this oversight committee and its recommended action, which resulted in BFF receiving a charter as of December 31, 2021. He further stated the Legislature, not the OSBC nor the State Banking Board, granted the charter during the 2022 Legislative Session (enactment of SB 337, which allowed the charter to be retroactive to the December 2021 date). The Commissioner noted subsequent amendments to the TEFFI Act in the 2022 Session (HB 2489) and the Act's codification within the Kansas Banking Code (Chapter 9, Article 23).

Examination and oversight. The Commissioner noted, unlike other financial institutions and entities regulated by the OSBC that have a federal regulatory counterpart, the agency serves as the sole regulator for TEFFIs. The Commissioner indicated the OSBC has completed three examinations of BFF since its charter became effective. The first two examinations have been reported to this Committee (these examinations focused on the Information Technology systems and compliance with the Bank Secrecy Act and Anti-Money Laundering laws [BSA/ AML]). A third examination was conducted during 2023 and included a review of BFF's administrative and operational practices and procedures, as well as a review of selected FidFin transactions. This examination, the Commissioner continued, evaluated potential areas of risks pertaining to BFF's business model and the State of Kansas. OSBC examiners apprised BFF's board and management of apparent statutory or regulatory violations and unsound fiduciary practices and procedures except as allowed by the TEFFI Act. The Commissioner further noted the 2021 law established a pilot program, with a sole participating TEFFI (economic growth zone [EGZ] designated in Harvey County). He observed that no other state has authorized TEFFIs and no other applications are pending in Kansas, so the OSBC is unable to make any other statement regarding market or worthiness for TEFFIs. [Note: Information generated by the OSBC in an investigation or examination is deemed

confidential information, pursuant to KSA 9-1712(a); such information, including the report and its findings, cannot be disclosed or made public by BFF, its directors, officers, or employees.]

Regulatory concerns: Safety and Soundness Examination. The Commissioner noted his ongoing concerns with some of the regulatory components contained in the TEFFI Act. Those concerns, some deepening, exist for any entrant into the TEFFI marketplace as the TEFFI legislation is not specific for just BFF, but rather legislation that will govern any future TEFFI should there be interest from other entities. The Commissioner stated it is still impossible to conduct a meaningful Safety and Soundness examination, highlighting the CAMELS rating system used for state-regulated banks that follows international industry standards and assigns ratings in compliance with a uniform ratings system. The Commissioner also noted examinations on regulated trust companies and trust departments assign ratings (*e.g.*, Management Operations, Internal Controls and Audits, Earnings, and Compliance and Asset Management), which are components of a uniform trust rating system. The Commissioner further stated the TEFFI Act specifically disallows an examination to consider earnings as a component and assigns any goodwill asset as a capital component, departures from the Uniform Financial Institutions Rating System, the Uniform Interagency Trust Rating System, and Generally Accepted Accounting Principles (GAAP). For a TEFFI, due to its business model, a significant asset category is the Fidfin transaction created by a TEFFI, which is a debt instrument. The Commissioner explained that in most cases, and as confirmed in testimony by BFF, no structured repayment of principal or interest nor any firm maturity debt is created for these debt instruments; consequently, under the rating system's guidelines, this type of instrument would be considered at least a "substandard asset" with a likelihood of it being rated "doubtful" or "loss," at which point it would be charged off the books. The Commissioner stated the Legislature should revisit these departures if a worthwhile Safety and Soundness examination is sought.

Other regulatory concerns. The Commissioner addressed the continuing challenge in securing certain background checks, noting the

original TEFFI Act failed to meet the requirements established by the FBI that permitted complete background checks on organizers of a TEFFI. The shortfall, he continued, is related to fingerprinting. The OSBC is working with the KBI to introduce legislation in the 2024 Session that will amend this act and other similar state laws to comply with FBI standards. Another concern cited related to recent transaction announcements by BFF, which have been funded with consideration other than cash, raising questions about the viability for BFF being able to fund itself in the future. Other concerns outlined by the Commissioner included negative press reports involving BFF's parent company (Beneficient), federal regulatory actions taken against Beneficient, the "freefall" of Beneficient's publicly traded stock, and public statements by Beneficient as well as its accounting firm regarding the company. The Commissioner noted the OSBC only regulates BFF, not its parent or any other subsidiary.

Discussion

The Committee and representatives of the OSBC discussed progress on legislation intended to address fingerprinting and background checks; the Commissioner confirmed ongoing work with other state agencies and his belief the legislation would be ready for consideration in the 2024 Session. The Commissioner responded to questions regarding Safety and Soundness examinations, its purpose, and the process the OSBC used to gain information and monitor TEFFI(s). The Commissioner indicated, at present, the agency has engaged several third parties, in areas including legal and accounting, as well as federal agencies (e.g., FBI and after Beneficient became publicly-traded, the U.S. Securities and Exchange Commission [SEC]). Discussion also focused on broader regulation of the alternative assets industry and other frameworks that could be used to oversee this industry and marketing and promotion activities to bring similar entities to Kansas.

Beneficient Company Group, LP [BFF, LLC]

The BFF President and Chief Fiduciary Officer (President); Managing Director and Co-Head, Fiduciary Financial Institutions; Senior Vice-President, Fiduciary Financial Institutions; and a legal representative from Crossroads Legal

Solutions provided an overview of recent Beneficient and BFF activities, an update on BFF operations, reporting on Economic Growth Zone (EGZ) milestones and achievement, and a request for a TEFFI advisory board.

Operations Report and Activities

Overview and comment. The President began by noting a number of important developments that have occurred in the last year. BFF's parent company, Beneficient, achieved its objectives of becoming a publicly traded company, which was an important element of BEN's business model, but also is important to BFF's ability to deliver products and services to its customers. The conferee also acknowledged the comments from the Committee chairperson and Commissioner regarding Beneficient's transition from a private to a publicly traded company and limitations placed on information (e.g., company stock, pending plans, and initiatives) he and other conferees could provide. The President further stated BFF is committed to providing information regarding TEFFI operations and the industry, as well as responding to questions and concerns that will allow the Committee to fulfill its oversight obligation. Another development highlighted is BFF's completion of its examination cycle with the OSBC; the President commended the OSBC and its examination team for a professional and responsive review process and the efforts by the OSBC to determine standards and expectations for oversight of the TEFFI industry and its unique business aspects. He noted that, with the conclusion of this examination cycle, the overall framework developed by the Legislature and this committee is working. He also indicated BFF is encouraged by the Strategic Economic Expansion and Development (SEED) program and the grants being awarded to Kansas communities through the Kansas Department of Commerce. The President also noted the potential economic impact for Kansas with additional TEFFIs present in the market and encouraged marketing and recruitment of this unique regulatory framework to the industry as a whole, through the use of moneys in the Technology-enabled Fiduciary Financial Institutions Development and Expansion Fund (Fund) and creation of an advisory board composed of industry professionals to help advise the Committee on participation, education, and broader regulatory matters. The President concluded his overview by acknowledging some

of the OSBC concerns, stating that any emerging companies that are pioneering a new industry and products and services are subject to challenges and headwinds; the organization as a whole is committed to delivering to the industry, being safe and sound, and providing to rural communities across the state.

The BFF President addressed the concerns and questions regarding a formal Safety and Soundness examination, stating BFF is not adverse to this type of standard. The challenge is the TEFFI operates in a different lane of financial services and application of more traditional standards does not fit the unique nature of the industry. BFF, he continued, is committed to participating in dialogue with the OSBC to identify appropriate standards to best address a Safety and Soundness review. The President noted the annual assessment paid by BFF to the OSBC could be used, in part, to outsource some of this consideration and customization of standards to appropriate third-party consultants. He also noted the role of federal regulators and legal compliance placed on BFF's parent company and other associated entities (e.g., SEC regulation and FINRA [Financial Industry Regulatory Authority]).

Operations. The Managing Director began his remarks by commenting on the examination process and the acute differences in the regulatory language for TEFFIs versus other financial institutions. The next step in this process, with completion of the pilot program and examination cycle, will be a review of proposed regulations and any legislative changes needed to bring the industry forward. It was noted that BFF and the OSBC continue to have discussions on examinations, and there is full access to key staff to assist with regulatory questions.

[*Note:* BFF representatives submitted two reports for the Committee's reference and record: Beneficent Fiduciary Financial, LLC Management Report – an asset & distribution statutory allocation reporting of the of Kansas Department of Commerce and Beneficent Heartland Foundation, Inc. activities; and Legislative Report for Kansas TEFFI Charitable Activity – including audited consolidated financial statements for the Kansas TEFFI Economic Growth Trust and the Beneficent Heartland

Foundation, Inc. – for the Fiscal Year, ended March 31, 2023.]

Economic impact, community projects. The Senior Vice President addressed the economic impact the TEFFI Act has had on the State of Kansas. He explained the TEFFI Act requires a statutorily established distribution, or allocation, of 2.5 percent of each TEFFI fee or surcharge (on fidfin transactions originated during the calendar year) to be set aside and held in the Beneficent Heartland Foundation ([BHF]; the designated “qualified charity” under the Act) to be allocated each year between the Department and BHF. The conferee stated that to-date there has been a total of \$16.6 million in assets assigned with \$5.8 million going to cash, \$2.7 million going to the Department's SEED program, and the balance of \$8.1 million going to Harvey County for the EGZ. Projects in Harvey county include the revitalization of the former grocery store building, relocation of a church from Main Street to another larger location to provide room for church activities and youth services, and the relocation of another business into a newly renovated store location to give the business an opportunity for increased sales and foot traffic (all locations in Hesston). Addressing the project for a new grocery store (anticipated construction start within next two years), the conferee noted the land assemblage has been finished and noted this project has added nine full-time executive-level employees, with the additional potential to create economic benefits to the community from businesses, equipment sales, sales taxes, income taxes, and moneys generated by contractors, laborers, and other consumers.

Advisory council. A representative of Crossroads Legal Solutions, outside legal counsel for Beneficent, next addressed the Committee, expressing appreciation for the work of the OSBC and concerns raised by the Commissioner, including the fingerprinting issues present for many state agencies and regulatory efforts for not only BFF, but any subsequent TEFFIs. The General Counsel also indicated BFF did not have any requests for legislative action. The BFF representative requested the Committee give consideration to next steps for the TEFFI industry.

Noting the dialogue on the regulation of the alternative assets management industry largely falls, presently, to the OSBC, BFF, the

Department, and this Committee, the General Counsel asked the Committee to consider a recommendation relating to the creation of an outside advisory committee of leading experts in the industry, to study and advise where we (*e.g.*, the Committee, regulators, and regulated entities) go from here and overall opportunities for growth; make recommendations on the oversight level; recommendations on the alternative assets industry; and, specifically, look at liquidity within the alternative assets industry. The conferee further indicated the group would not require a statutory charge, nor would members receive compensation or be appointed legislators. This advisory group would then be able to provide a broader perspective, separate from BFF's, to the Committee at future meetings.

Discussion

The Committee and BFF representatives discussed the relationship of BFF to its parent company (general discussion regarding market conditions) and the importance of the technology-enabled platform. The CFO responded this platform is key for BFF's customers to effectively conduct transactions. Another topic addressed was the current distribution of charitable assets and other permissible uses. The Committee and conferees also discussed notifications that could occur should there be a breach or other cyber incident.

Kansas Department of Commerce

The Director of Legislative Affairs for the Department addressed requirements in the TEFFI Act that established the Fund, which is administered by the agency. The Act requires Fund expenditures to be used for economic development projects in the EGZ in Kansas; promoting and facilitating the development and growth of trust banks, fidfin activities, and custodial services in Kansas; and location of trust bank office space in an EGZ.

SEED. After receiving funding, the Department developed the SEED grant program, specifically designed to award grants that support the economic revitalization of Kansas communities with population under 5,000 people through investments in quality-of-life initiatives. During the first round of awards, 109 applications

were received with a total of \$4.7 million requested. The first funding to the Department was \$2.7 million. With those funds, the Department awarded grants to 61 applicants in December 2022.

A second round of SEED funding was announced by the Department in August 2023, with a deadline for applications of October 27, 2023. Eligibility criteria remained largely the same excepting the reduction in the maximum award per grantee from \$50,000 to \$25,000. The Department conferee indicated the agency had received 68 applications (requesting a total \$1.6 million) to be addressed by available funding of \$270,000. It was noted award announcements were anticipated in December 2023. [*Note: According to a December 21, 2023, Department press release, 13 recipients were selected to receive nearly \$275,000 for investment across those small communities.*]

Discussion

The Committee and the Department conferee discussed routine reporting, including project metrics, to the Legislature after completion of the first round of SEED grant projects (*i.e.*, 12 months from award receipt) to ascertain more information about the projects' awards, costs, and completion. The Committee and conferee also discussed efforts to secure future TEFFIs and target funding to those potential locations/ communities, as well as the use of the Fund for marketing and promotional purposes.

CONCLUSIONS AND RECOMMENDATIONS

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

- **Advisory group.** The Committee encourages the formation of an *ad hoc* group and dialogue with both the relevant standing committees of the Legislature and this committee.

The Committee directs its report to the relevant standing committees of the Kansas Legislature for additional review during the 2024 Session.