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Testimony to Joint Committee on Technology Enabled Fiduciary Financial Institutions (TEFFIs)

December 1, 2022

Mr. Chairman and members of the Joint Committee on Fiduciary Financial Institutions Oversight:

My name is David Herndon. I am the Kansas State Bank Commissioner. The agency I lead is the Office of the State Bank Commissioner or OSBC. We are the sole financial regulator for Technology Enabled Fiduciary Financial Institutions or TEFFI's. OSBC received this designation by the creation of the TEFFI Act legislation adapted two legislative sessions ago by the State of Kansas.

I appear today to provide an update to the Committee on the status, from the perspective of OSBC, of the state's Pilot Program for TEFFI's and the activities of the participant in the Pilot, Beneficient Fiduciary Financial, L.L.C. (BFF). I am joined today by Deputy Commissioner Tim Kemp and OSBC General Counsel, Brock Roehler, both of whom can provide additional comments as well as answer questions of the members.

We experienced material delays in BFF's application submission. Most significant among them was the inability for BFF to provide audited financial statements, required as part of our application process and our inability to obtain background checks conducted by the Federal Bureau of Investigation (FBI) because of the way the TEFFI Act is written. Both of these issues have previously been reported.

The audited financial statements for the periods ending December 31, 2020, December 31, 2021 and March 31, 2022, were delivered by BFF to OSBC October 27, 2022, resolving that application delay. Regrettably we have not made any headway with the FBI regarding background checks so have relied on alternative checks.

At its November 21, 2022, regular meeting, the State Banking Board, the entity that acts on applications for activities by state-chartered banks and state-chartered trust companies, recognized that BFF's authority to transact business was enacted by the Kansas legislature essentially granting BFF a charter to do business pursuant to K.S.A. 9-2325(d)(1). Consequently, the board has taken no action on the BFF application. But the OSBC and the State Banking Board does consider BFF's application complete as required by K.S.A. 9-2325(a)(1).

Other items recognized by the State Banking Board regarding BFF's state-granted charter include:

- The Banking Board's authority to approve or deny Ben's license pursuant to K.S.A. 9-2302 was superseded by Beneficient's satisfying all conditions of K.S.A. 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 Ben's officers; and
- The pilot program has concluded, and the Banking Board has authority to approve or deny any other TEFFI charter applications submitted pursuant to K.S.A. 9-2302.

Notwithstanding the actions by BFF to complete the application process, the fidfin transactions that have been generated, the due diligence conducted by OSBC and the recognitions by the State Banking Board, the concerns I have previously expressed regarding the OSBC's ability to conduct meaningful examinations remain. In particular, the limitations in the TEFFI Act that disallow consideration of safety and soundness principles established by universal and international industry standards as well as departures from Generally Accepted Accounting Principals have and will hamper, even diminish our examination activities. Therefore, I once again, request consideration by this Committee and the Kansas legislature to allow us to conduct the type of examination as we do for Kansas state-chartered banks and trust companies.

However, the OSBC has conducted two targeted examinations of BFF in 2022 and has scheduled a third to commence this month. The two targeted examinations were an Information Technology (IT) Exam and a Bank Secrecy Act (BSA) exam. Both of those were completed this past summer. All examinations conducted by OSBC are confidential in nature between OSBC and the board of directors for the examined entity pursuant to K.S.A. 40-3308, so particular findings cannot be disclosed. However, Deputy Commissioner Kemp will report on the findings and conclusions that may be disclosed outside of the confidentiality restrictions.

The third examination, scheduled to commence December 19, 2022, will target BFF's business operation as well as selected transactions it has conducted, and determine a Pass/Fail result regarding BFF's compliance with the TEFFI Act. Since the TEFFI Act as written precludes OSBC from conducting a safety and soundness examination that meets standards, a Pass/Fail examination determination finding is the alternative.

As a result of the State Banking Board's recognition of the transactional authority granted Ben by the Kansas legislature and the anticipated successful conclusion of the third examination, the OSBC considers the provisions of the Pilot Program will be complete and the Pilot Program can be concluded.

If the Pilot Program is indeed concluded, other TEFFI businesses would be permitted to apply for charter in Kansas. I can report however, that as of today no inquiries have been made to OSBC from potential applicants.

There are some other influences and matters OSBC is monitoring regarding business connections and interlocking management between BFF and a former affiliate GWG Holdings, Inc. OSBC understands the business relationship between BFF and GWG has severed but a bankruptcy filing by GWG and an ongoing Securities and Exchange Commission regarding GWG's business are being followed by OSBC and will be acted upon if BFF or its principal are adversely impacted. OSBC respects that GWG is not our concern as it is not our applicant. But no representation or expectation is expressed as to any involvement by BFF or its management in GWG's activities.

Now, with the Chairman's permission, I'd like to turn the podium over to Deputy Commissioner Tim Kemp to discuss the examinations I referenced. And then to General Council Roehler to discuss potential legislative actions OSBC respectfully request be considered.

Thank you.

Mr. Chairman, Members of the Committee:

I am pleased to report that the OSBC has completed two examinations for BFF to determine if industry standards and regulations have been met in the areas of BSA compliance and IT. Examination reports, materials, and ratings are confidential; however, without getting into specifics, I can state that BFF was well-prepared for these examinations and examiners found BFF to be in a position that did not cause any deep concern in the areas of BSA and IT. The BSA examination was completed by TEFFI examiners Aaron Emerson and Kristy Umscheid. The IT examination was completed by TEFFI examiners Michelle Kelly and Aaron Emerson. Examiners appreciated the prompt responses of BFF to requests for materials/data which helped the examinations to be completed in a timely fashion.

A third examination designed to determine compliance with the TEFFI Act is scheduled to commence with an on-site visit to BFF's Hesston office on December 19. Certain materials have been requested and received from BFF for examiners to analyze and conduct offsite review. This is very helpful so that time spent onsite can be as productive and efficient as possible. A visit to the Beneficient Dallas, Texas, office will likely occur in the early part of January although not all details have been finalized. Due to the uniqueness of the TEFFI business model and BFF being the first TEFFI in existence, there is no anticipated completion date. There is no template for this type of examination hence procedures to be utilized are being developed and may need adjusted at some point during the examination. Every effort will be made to complete the Report of Examination as soon as possible while also ensuring that a comprehensive review is performed.

Common practice is for de novo financial institutions to receive annual examinations for at least the first three years of operation. The OSBC expects to treat a TEFFI in a consistent manner with other financial institutions, and as such, annual examinations are anticipated for the initial three years of operation. Future examination schedules will be dependent on examination findings and the activity of BFF.

To aid in the communication between the OSBC and BFF, it was mutually agreed upon that Deputy Commissioner Tim Kemp and Managing Director/Co-Head of Fiduciary Financial Institutions Alan Deines would meet monthly, in person, to discuss current issues of concern, including the scheduling of examinations. The discussions have included items that have gone well and those items that have not gone as well. It is truly a discovery of what is needed to properly regulate a TEFFI. These meetings have resulted in improved dialogue between the parties and is seen as beneficial as we continue to develop standards and expectations from regulated entity and regulator.

Mr. Chairman and members of the Committee:

My name is Brock Roehler, General Counsel for the Office of the State Bank Commissioner (OSBC). I am here today to discuss a proposed bill to amend two statutes in the TEFFI act.

Our agency still is unable to receive background checks on any TEFFI officer, director or organizer. Despite implementing all of the changes requested by the Federal Bureau of Investigation in 2021 House Bill 2489, the FBI still has refused to permit the OSBC to submit and receive background checks. This bill will amend two statutes.

First, we are requesting to add definitions to K.S.A. 9-2301 to define an “officer,” “director,” and “organizer.” These are the individuals subject to background checks under K.S.A. 9-2302. Second, we are requesting to amend K.S.A. 9-2302 to clarify that the commissioner has authority to require fingerprinting. The OSBC as a customary practice requests and reviews background checks on behalf of the State Banking Board. Second, as a condition to receive background checks from the FBI, we are required to agree not to accept private entity criminal history checks. I am proposing new language that complies with this request provided we are able to receive background checks from the FBI and KBI. We also are required to not disclose criminal history information for any other purpose and to treat the background checks as confidential. The OSBC does not view these last two issues as significant issues.