



Business Development
Company Act of 2006
Chapter 31.24 RCW



GUIDE TO BUSINESS DEVELOPMENT COMPANIES

Washington State Department of Financial Institutions
1-877-746-4334 www.dfi.wa.gov

Introduction

The Department of Financial Institutions (“DFI”) recognized a prevailing need to stimulate small business, agriculture, community development and historic preservation in many local communities throughout Washington State. DFI also believed that it could overhaul and modernize an obscure and seldom-used industrial development company law to help meet these needs, while at the same time facilitating compliance with the Community Reinvestment Act by banks and thrifts serving Washington State.

The result was the enactment by the Washington State Legislature of the Business Development Company Act of 2006 (“Act”) administered by DFI’s Division of Banks.

Basics of the New Act

The new Act facilitates an innovative type of **financial institutions charter**, which encourages banks, thrifts and/or credit unions, the investment community, private entrepreneurs, and even government-sponsored entities (GSEs) to form business development companies that will lend to or invest in small business, agriculture, community development and/or historical preservation.

The new Act was designed to promote the financial integrity of banks and savings banks by making it easier for them to be in compliance with their Community Reinvestment Act obligations. Second, the Act helps assure banks and thrifts that the business development companies in which they invest abide by safe and sound practices. Third, the Act helps eliminate unfair barriers to entry for small business, agriculture and community development projects by improving access to credit and choice of financial products. And finally, by encouraging all of the above, the Act helps enhance the economic vitality of the state.

DFI had four main goals in drafting the new Act:

- **“User-Friendliness”**. The Act had to be user-friendly, in the sense that business development companies ought to be easier to charter, govern, raise capital, attract stakeholder participation, and manage. Accordingly, creative business plans might emerge that are market (need) driven.
- **“Open Source”**. There was a need for open source stakeholder participation, rather than the previous law’s “closed system” of 10 or more banks with rigid rules for “membership” and “assessment.” This is designed to stimulate a cross-fertilization of ideas through joint participation by depository institutions, the investment community, entrepreneurs, and GSEs.
- **“Cafeteria Plan”**. DFI designed a cafeteria plan approach to permissible company activity, which permits flexibility and choice in how stakeholders participate, thereby fostering sustained interest.
- **Stakeholder Trust**. DFI seeks to encourage stakeholder trust in participation by assuring banks and other participants that there will be proper regulatory oversight, safety and soundness in an atmosphere of confidential examination.

Chartering Requirements

Form of Business.

- **Profit Enterprise.** A business development company must be a for-profit enterprise. However, a government sponsored entity (GSE) or other non-profit corporation may participate as an investor, incorporator or participating lender.
- **Corporation.** Typically, a business development company will be a Washington “C” or “S” corporation with articles of incorporation and bylaws as prescribed by the Act.
- **Limited Liability Company.** A business development company is permitted to form or convert to doing business as a Washington limited liability company with articles of association and bylaws as prescribed by the Act.

Incorporators.

- **Minimum Number of Incorporators.** There must be at least five (5) incorporators as founders of a business development company.
- **Financial Institution Involvement.** At least three (3) incorporators must be federally insured depository institutions — FDIC-insured banks or NCUSIF-insured credit unions. This requirement assures that the core founder group will include a strong financial management base. While all lending and investment must be principally in Washington State, incorporators that are banks or credit unions need not be chartered or have their principal offices in Washington State. This opens the field to the use of a business development company for investment in Washington State by out-of-state institutions. A non-U.S. bank, however, must be FDIC-insured in order to participate as an incorporator/founder. The “lead incorporator/founder” need not be a financial institution, which opens a business development company charter to entrepreneurial leadership or even GSE sponsorship.
- **Credit Unions.** NCUSIF-insured credit unions may now participate as incorporators. A credit union service organization (“CUSO”) may be formed as a business development company. However, participation by a Washington State-chartered credit union or affiliated CUSO in a business development company is subject to advance approval of the Division of Credit Unions prior to charter approval by the Division of Banks.

Articles and Bylaws.

- **Special Articles.** The language of the articles of incorporation or association must conform to the special requirements of the Act.
- **Approval.** While the articles of incorporation or association are filed with the Secretary of State, they must be approved by the Division of Banks. The Division of Banks must also approve the bylaws. Any amendment to the articles of incorporation or association must also be approved by the Division of Banks.

Mission.

A business development company's business plan must reflect a dedication to:

- Investment and/or lending to **small business**;
- Investment and/or lending to **small commercial agriculture**;
- **Community development** investment and/or lending;
- Investment and/or lending to **historic preservation projects**.

A business development company may invest or lend state-wide. The core mission of a business development company, as contained in its business and operation plan, may be:

- **Generic.** The primary mission may be state-wide investment and lending not oriented toward any particular industry sector.
- **Geographic.** The primary mission may be geographic in the sense of being dedicated to investment and lending within a specific geographic locality — municipality, county or self-defined region — within Washington State. A region may encompass some portion of a neighboring state, provided that any investment or lending project of the business development company is primarily situated in and will thus primarily benefit Washington State.
- **Sector-Oriented.** A business development company may also decide, as reflected in its business and operational plan, to make it primary mission investment and lending to a specific industry or industry sector. For example, a business development company may focus on emerging technologies, viticulture, agricultural bio-energy, retail-core revitalization, or even micro-business.
- **Historic Preservation.** A business development company may even be formed for the specific purpose of historic preservation of a small town or specific urban neighborhood.

Business Plan.

- **Core of Application.** The proposed business plan is the principal core of any application to charter a business development company in Washington State. Accordingly, considerable research, deliberation, planning and detail must be reflected in any business plan that is submitted to the Division of Banks for approval of a charter.
- **Approval.** The Division of Banks must approve the business plan as a condition of any grant of a charter to operate as a business development company. If a business development company makes a significant and material change in its business plan that would affect its core business model, such a change will be subject to the safety and soundness examination authority of the Division of Banks. The business plan must be consistent with the mission of the business development company. Also, it must appear to the Division of Banks that the business development company has a reasonable likelihood of safe and sound operation and the ability to fulfill its stated goals.
- **Contents.** An acceptable business plan will usually contain the following elements:
 - Executive Summary.
 - Mission Statement.
 - Description of the Business.
 - Operational Plan.
 - Lending and Investment Strategy.
 - Types and Mix of Lending.
 - Types and Mix of Investment.
 - Marketing Plan.
 - Market Analysis.
 - Economic Component.
 - Demographic Analysis.
 - Competitive Analysis.
 - Management Plan.
 - Directors.
 - Officers.
 - Governance Plan.
 - Loan Committee.
 - Investment/Asset and Liability Committee.
 - Audit Committee.
 - Committee Members.
 - Organizational Structure.
 - Duties and Responsibilities of Senior Executives.
 - Plan of Records, Systems and Controls.
 - Audits.
 - Regulatory Compliance Policy Guidelines.

- Financial Management Plan.
 - Capital and Earnings Strategy.
 - Plan of Capitalization.
 - Sensitivity to Market Risk.
 - Credit Risk.
 - Revenue and Earnings Projection.
 - Sensitivity Analysis.
 - Overall Business Strategy.
 - Pro Forma Financials.
- Alternative Business Strategy (if any).

Notwithstanding the above, some business plans will require more detail and consideration than others, depending upon the mission and goals of the business development company.

Quality of Management.

- **Qualifications and Experience.** Quality of management is one of the most critical factors in an acceptable charter application. Each candidate for management, depending on his or her proposed role in the business development company, should demonstrate the qualifications and experience that, in the view of the Division of Banks, are necessary, at a minimum, to succeed in the assigned role. A heavy emphasis will be placed on financial management qualifications and expertise of key managers in relation to financial accounting, managerial accounting, investment, lending, and/or portfolio management. The Division of Banks will closely evaluate related education as well as relevant and sufficient financial services experience of key managers.
- **Integrity.** Credit history, employment history, and any past experience bearing on one's fiduciary integrity and honesty will also be a factor for the Division of Banks in determining the acceptability of management.

Capitalization Requirements.

- **Minimum Capital-to-Asset Ratio.** The minimum ratio of total capital (including paid-in capital, capital surplus and undivided profits) to total assets must be not less than eight percent (8%).
- **Consistency with Business Plan and Goals.** Initial core capital must be adequate, in the opinion of Division of Banks, and consistent with the goals of the business plan.

Business Model Examples

- **Encouraging Variety and Creativity.** The Act encourages variety and creativity in business models. Given the general chartering requirements of the business development company described above, there are numerous alternative business models which may be suitable for a business development company charter. As briefly described above, a business development company may generally serve small business, small commercial agriculture, community development, and/or historic preservation projects. While a business development company may have a generic state-wide purpose, an alternative focus may otherwise be local or regional in nature or related to a specific industry or industry sector.
- **Creativity in Formation and Structure.** The Act permits variety and creativity, as well, in formation and structure of a business development company. A founder-incorporator-capital investor structure may take a variety of creative forms, as illustrated by just a few examples:

Illustration 1: Entrepreneur-Promoter/Financial Institution Model.

Lead founder/entrepreneur puts together founder/investment group consisting of one national bank, two state banks and an individual, non-institutional investor.

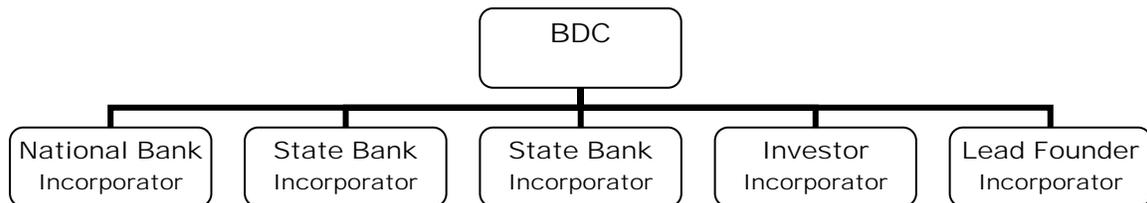


Illustration 2: Lead Financial Institution Model.

Bank 1, acting as lead founder, forms BDC and brings in Bank 2, Bank 3, Bank 4 and an individual, non-institutional investor as additional founding incorporators.

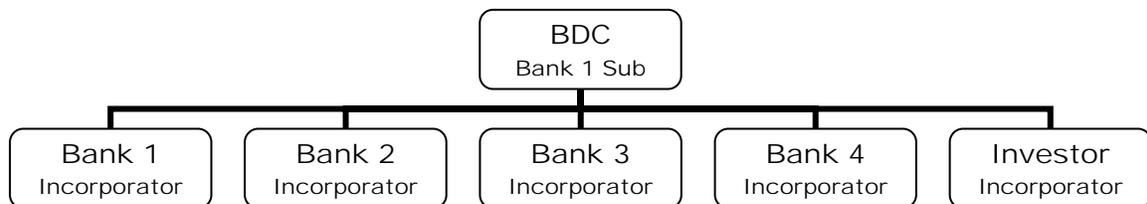


Illustration 3: Non-Profit Sponsorship Model.

Community development non-profit corporation forms BDC and brings together Bank 1, Bank 2, Bank 3 and a non-institutional, community development investor as additional incorporators.

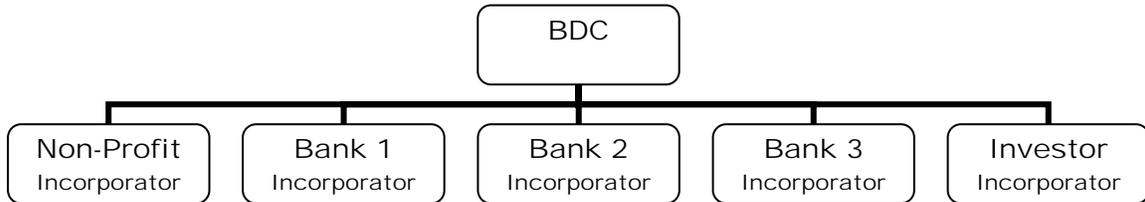
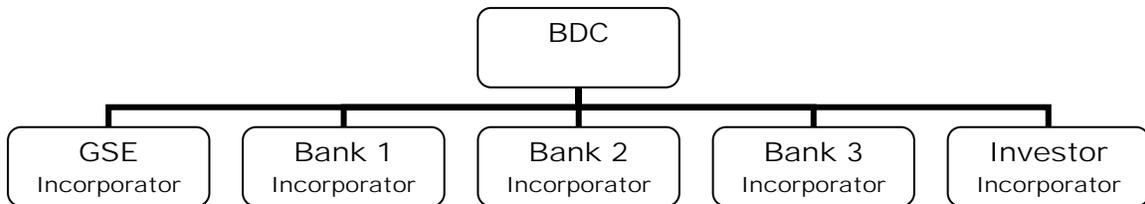


Illustration 4: GSE Sponsorship Model.

Wholly owned subsidiary of City (GSE) forms BDC to perform urban neighborhood revitalization and brings in Bank 1, Bank 2, Bank 3 and a non-institutional developer-investor as additional incorporators.



Operational Requirements

Once formed, the operation of a business development company charter will be subject to straightforward, flexible, and functional regulation.

- **Regular Safety and Soundness Examination.** A business development company will be subject to a state safety and soundness examination every 24 months.
- **Maintenance of Leverage Ratio.** A business development company must maintain a minimum ratio of total capital (including paid-in capital, capital surplus and undivided profits) to total assets of not less than eight percent (8%), also known as a minimum leverage ratio.
- **Lending/Investment Limits.** In harmony with the principle underlying Federal Reserve Regulation O and other similar lending limits, the aggregate amount of qualified loans and investments of a business development company to any single borrower or business entity may not exceed twenty five percent (25%).

- **Insider Transactions.** Insider transactions must be ratified by the board of directors and are subject, in any event, to safety and soundness review and examination by the Division of Banks.
- **Confidentiality of Examination Reports.** In keeping with statutes for state-chartered banks and thrifts, examinations reports will be confidential and exempt from Washington's public disclosure law.

Further Information

For further chartering and operational details, see [RCW 31.24](#).

For further general inquiries, contact Deborah Bortner, Regulatory Counsel, at (360) 902-0511, or the Division of Banks, at (360) 902-8704. For inquiries related specifically to credit union or CUSO participation, please contact the Division of Credit Unions, at (360) 902-8701.