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MODERNIZING THE REGULATORY FRAMEWORK FOR BDCs

Recent legislation amends the regulatory framework applicable to BDCs, and is designed to remove past obstacles and put their securities offerings on a par with those of operating companies. The author discusses the past regulatory framework creating impediments for BDCs, and then turns to the new legislation and the mandated changes to SEC rules.

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Even though nearly 10 years have elapsed since the onset of the financial crisis, lending by banks to small- and medium-sized enterprises has not returned to pre-financial crisis levels. Dodd-Frank Act mandated-regulations, changes brought about by the implementation of Basel III rules, and restrictions on leveraged lending together have had the effect of limiting the willingness of banks to lend to smaller businesses. This has created a lending void, and this void has been filled in large measure by non-bank or alternative lenders.[1] Business development companies, or BDCs, have become increasingly more important as direct lenders that provide needed funding to smaller companies. Recognition of the important role played by BDCs may have served as an important catalyst for the adoption of recent legislation that amends the regulatory framework applicable to BDCs. This article provides an overview of these changes.

AN OVERVIEW OF BUSINESS DEVELOPMENT COMPANIES

BDCs often are referred to as hybrid vehicles. Although BDCs are closed-end investment companies, they are exempt from many of the requirements typically imposed by the Investment Company Act of 1940 on funds. BDCs originally were envisioned as public vehicles that would provide venture capital type funding to portfolio companies. Early BDCs tended to invest in the equity securities of private companies, following a venture capital fund investment approach. By contrast, it is more often the case that recently formed BDCs invest in senior or subordinated debt securities of private companies. Under the Investment Company Act, a BDC is defined as a domestic closed-end company that: (1) operates for the purpose of making investments in certain securities specified in Section 55(a) of the Investment Company Act and, with limited exceptions, makes available significant managerial assistance with respect to the issuers of such securities and (2) has elected business development company status. Generally, a substantial percentage of a BDC's total assets must be comprised of investments in privately issued securities purchased from eligible portfolio

[1] Andrea Beltratti and Jonathan Bock, "BDCs: The Most Important Commercial Lenders You've Never Heard About," Journal of Alternative Investments, 2018, 20 (4), pp. 8-20.

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