



Native American Capital, LP

A Private Equity Fund Serving Indian Country

Policy Briefing: Native American Tribes Require Reg D Change

Background

Over the past 15 years, a significant minority of American Indian Tribes has experienced unparalleled economic success through their ventures into gaming, manufacturing, and government contracting, yet they are not considered to be “accredited investors” by United States securities law. Economic successes in Indian country (in no small measure the result of the Federal Government’s efforts to assist tribes to develop their economies) is now challenging Federal Regulations developed in an earlier era to protect tribes in their special status as “wards” of the United States. Some of these regulations (e.g., IRS Tax Codes relating to municipal bond issuing authority) explicitly single out American Indian Tribes in ways that today, unwittingly, inhibit full economic sovereignty. Other regulations, however, retard economic self-sufficiency as a result of mere oversight, or, “benign neglect.” One such regulatory oversight is the failure to include American Indian Tribes in the list of ‘accredited investors’ under Regulation D of the Securities Act of 1933.

American Indian Tribes and Investment Capital

For a growing number of American Indian-sponsored venture capital and private equity firms that are seeking to raise funds from prosperous American Indian Tribes, the practical effect of tribes being defined as “non-accredited investors” is to eliminate this important source of funding. Since these private equity firms are mission-driven to reinvest their raised capital back into Indian Country business projects, the net effect of tribes being deemed non-accredited is to inhibit capital formation and investment in Indian Country.

Regulation D of the *Securities Act of 1933* specifies rules governing the selling of securities by private companies and exemptions from Federal and state securities registration requirements. Small Business Investment Companies (SBICs) and other small private equity firms regularly avail themselves of the so-called “Reg D” exemption. While there are a number of pathways through which a private equity firm can avail itself of this filing exemption, as a practical business matter, the pathway most commonly followed and looked to by successful firms is to offer their securities ONLY to Accredited Investors.¹

Rule 501(a) of Reg D (last amended in 1989) defines who is or is not an Accredited Investor within the meaning of the Reg D exemption. Private venture capital/equity companies are most desirous to sell securities ONLY to Accredited Investors because, only under this scenario, are the companies assured of being in complete compliance with Federal and State securities laws. While a private company may sell its securities to categories of investors other than accredited ones, these alternative scenarios create significant legal complexities and business risks which increase the costs of raising capital (e.g., risk premiums must be paid to investors, as well as much higher legal fees, and more detailed disclosure documents).



As a general rule, securities lawyers advise startup private equity funds to restrict the sale of securities (i.e., raise their “blind pool” of capital) to Accredited Investors, given the high risk nature of equity investments. In short, a private investment firm that must raise its capital from non-accredited investors will pay higher costs for these funds.

As noted, the categories of persons or entities that are included in the list of Accredited Investors under Rule 501(a) have not been updated since 1989, prior to the rapid economic development in Indian country. According to Gerald J. Laporte, Chief, Office of Small Business Policy, SEC, the prospect of prosperous American Indian Tribes seeking to invest substantial sums of money in private companies or other investments is a subject that the SEC staff would like to address. Mr. Laporte stated that he thinks the SEC staff would support including American Indian tribes in the listing of Accredited Investors once the SEC has addressed other issues on its rulemaking agenda, such as changes occasioned by the collapse of Enron and other large corporations and the passage of the Sarbanes-Oxley Act in 2002.

The omission of American Indian Tribes from the Accredited Investors list has now become a matter of concern for a growing number of prosperous tribes and their financial advisers, as they seek to invest their capital like other successful Americans and corporate enterprises. The growing prosperity of some American Indian Tribes via gaming, manufacturing, and government contracting suggests that it is now time for the SEC to add American Indian Tribes to the Rule 501(a) list of Accredited Investors under Regulation D.

The rule should be changed so that any American Indian Tribe, or entity in which all of the equity interests are owned by an American Indian Tribe, with non-trust assets² in excess of \$5 million, shall be considered to be an Accredited Investor.

Notes

(1) Rule 501(a) of Regulation D of the Securities Act of 1933

Accredited investor. Accredited investor shall mean any person who comes within any of the following categories, or who the issuer reasonably believes comes within any of the following categories, at the time of the sale of the securities to that person:

- a. Any bank as defined in section 3(a)(2) of the Act, or any savings and loan association or other institution as defined in section 3(a)(5)(A) of the Act whether acting in its individual or fiduciary capacity; any broker or dealer registered pursuant to section 15 of the Securities Exchange Act of 1934; any insurance company as defined in section 2(a)(13) of the Act; any investment company registered under the Investment Company Act of 1940 or a business development company as defined in section 2(a)(48) of that Act; any Small Business Investment Company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958; any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of \$5,000,000; any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974 if the investment decision is made by a plan fiduciary, as defined in section 3(21) of such act, which is either a bank, savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of \$5,000,000 or, if a self-directed plan, with investment decisions made solely by persons that are accredited investors;



- b. Any private business development company as defined in section 202(a)(22) of the Investment Advisers Act of 1940;
- c. Any organization described in section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of \$5,000,000;
- d. Any director, executive officer, or general partner of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of that issuer;
- e. Any natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase exceeds \$1,000,000;
- f. Any natural person who had an individual income in excess of \$200,000 in each of the two most recent years or joint income with that person's spouse in excess of \$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year;
- g. Any trust, with total assets in excess of \$5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in Rule 506(b)(2)(ii);
- h. Any entity in which all of the equity owners are accredited investors.
- i. ***Any American Indian Tribe, or any entity in which all of the equity interests are owned by an American Indian Tribe, with non-trust assets² in excess of \$5 million. (proposed rule change)***

(2) Non-Trust Assets are defined as any assets currently under the direct control of the American Indian Tribe, or entity owned by the American Indian Tribe, and not held in Trust for the Tribe by the United States Government through the Trust Responsibilities delegated to the United States Bureau of Indian Affairs.

