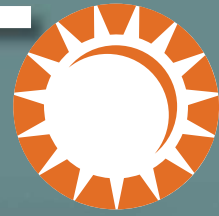


# the NAFOA NAVIGATOR



FALL 2020

A composite image featuring a bald eagle perched atop a globe, which is set against a background of a river with rapids. Another eagle is shown in flight to the right, and a third eagle is in the foreground at the bottom, flying towards the viewer. The scene is set in a forested area with mist or fog.

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# SEC Rule Change

## allows tribes to be accredited investors

are tribal sovereign wealth funds in the near future?

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The Securities and Exchange Commission (“SEC”) recently amended its rules to permit tribes to qualify as “accredited investors” which allows tribes to access private investments in private equity, hedge and venture capital funds and invest directly in private capital raises by businesses. Consequently, tribes now have an additional tool for economic diversification and a greater opportunity to generate income – investment income.

### The New Final Rule

The SEC’s action, taken on August 26, 2020, amends Rule 501(a) of Regulation D (the “Final Rule”), promulgated under the Securities Act of 1933, as amended (“Securities Act”).<sup>1</sup> The amendment adds a category of “accredited investor” defined as “an entity . . . not formed for the specific purpose of acquiring the securities offered, owning investments<sup>2</sup> in excess of \$5,000,000.”<sup>3</sup> It is this new category of “accredited investor” that is most significant to tribes. While tribes are not expressly identified in the amendment language, the SEC in its Final Rule stated, “[w]e believe the term ‘entity’ is sufficiently broad in this context to encompass Indian tribes and the divisions and instrumentalities thereof.”<sup>4</sup>

Historically, tribes seeking to invest in private market opportunities have faced obstacles to participation, including the threshold problem that

<sup>1</sup> SEC Release Nos. 33-10824; 34-89669, published August 26, 2020. The Final Rule also broadens the definition of “qualified institutional buyer (“QIB”) under Rule 144A to include “accredited investors” that satisfy the \$100 million securities owned threshold in the definition of QIB.

<sup>2</sup> Note 1 in the Final Rule to this new paragraph (a)(9) clarifies that as used in this new definition, “investments” is defined in Rule 2a51-1(b) under the Investment Company Act of 1940, and includes among other things: securities; real estate, commodity interests, physical commodities, and non-security financial contracts held for investment purposes; and cash and cash equivalents.

<sup>3</sup> Once the Final Rule is effective, 17 C.F.R. § 230.501(a)(9).

<sup>4</sup> Final Rule, page 55.

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## sec rule change continued

tribal governments did not meet any of the definitions of “accredited investor.” As a result, for a private equity sponsor or fund to accept an investment from a tribe, the tribe typically needed to form a corporation or limited liability company that otherwise met one of existing definitions or SEC interpretations of “accredited investor” under Rule 501(a).<sup>5</sup> Tribes will no longer need to take that additional step and can directly invest in a private investment. The Final Rule will become effective 60 days after publication in the Federal Register.<sup>6</sup>

### Practical Implications of the Final Rule

The SEC’s action comes at a time when tribes have become painfully aware of their dependence upon tribal gaming revenues. According to the National Indian Gaming Commission, some 526 tribal gaming operations temporarily closed due to the COVID-19 pandemic.<sup>7</sup> Faced with the possibility of future gaming disruptions resulting from the pandemic, many tribes feel compelled to accelerate their efforts at economic diversification.

What are the practical implications of this rule change? Will tribes now establish their own tribal sovereign wealth funds? Maybe. In reality, some wealthy tribes already have established investment fund vehicles to diversify their economies and provide investment income to their governments. For other tribes, the failure to qualify as “accredited investors” probably hasn’t been the primary barrier to participation in the private investment market. The lack of widespread participation is complicated and attributable to a host of factors. Chief among them is the “fear of the unknown” by both fund sponsors and tribes themselves. Most fund sponsors generally lack an understanding of tribal governmental organization and tribal laws, are concerned about sovereign immunity and how to enforce capital calls and obligations to return distributions for fund liabilities and cannot rely on a well-established course of conduct as they can for other governmental investors, such as state pension funds. Tribal governments have been blocked from entering the private investment market not just by the “accredited investor” rule but also by federal restrictions on

investments of federal funds, concerns about placing critical tribal revenues at perceived risk, insufficient “excess” financial resources to invest and limited internal and external resources to confidently assess investment risk.

### Tips for the Tribal Accredited Investor World

Education of all players -- tribal investors, fund sponsors and private issuers – will be the key to capitalizing on the opportunities presented by the Final Rule. Non-tribal participants will need to get up to speed on issues such as tribal entity organization, tribal law, and principles of sovereign immunity. Tribal participants new to private investing will need to develop policies, training protocols and mechanisms to evaluate fund sponsors, investments and risk. A checklist for a successful transaction should include, among other things:

- Engagement of established professionals:
  - Registered Investment Advisers
  - Investment Consultants
  - Legal counsel with both securities law and tribal law experience
- Conduct of rigorous business and legal due diligence (including background checks)
- Legal review of fund and/or subscription documents for material legal issues
- Development of clear investment policies
- Training on securities laws and tribal law

While the SEC’s rule change is a significant step in expanding tribal participation in capital formation and private investment opportunities, it will take trailblazers, publicized transactions, public awareness, cultural adaptations and patience by all players to fully capitalize on the opportunity presented. ■

*You may contact authors Christine Swanick or Daniel Clausen at Sheppard Mullin Richter & Hampton LLP if you seek additional information.*

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<sup>5</sup> See 17 C.F.R. 230.501(a)(3) and Final Rule 501(a)(3) explicitly adding “limited liability company” to the text.

<sup>6</sup> Publication in the Federal Register was pending as of the date of submittal for publication.

<sup>7</sup> See NIGC Guidance Regarding COVID-19, Frequently Asked Questions, August 5, 2020 Updated FAQs, available at [https://www.nigc.gov/images/uploads/NIGC\\_COVID19\\_FAQ\\_Updates\\_FINAL\\_TLC\\_08052020.pdf](https://www.nigc.gov/images/uploads/NIGC_COVID19_FAQ_Updates_FINAL_TLC_08052020.pdf) (last visited Sept. 17, 2020).