EB-5 Law and Practice Following the Jobs Act

The SEC's proposed rules under the JOBS Act will change the practice of law relating to EB-5 offerings. Regional centers and other EB-5 issuers (“direct investments”) will have more latitude with respect to general solicitations and general advertisements. However, the effort and cost to comply with securities law will increase significantly due to the “reasonable steps” requirement. Proof of “reasonable steps" taken to verify accredited investor status will now be a condition to the availability of the exemption under Rule 506 (c). Lawyers working in this field will need some familiarity with both securities law and EB-5 law.

The most commonly used exemption in EB-5 offerings is Regulation D (private placements). Regulation S offshore offerings exemptions are far less frequently used. Without either exemption, issuers must register their offerings with the SEC and disclose information similar to what public offerings require. Failure to comply subjects an issuer to prohibitive penalties and fines and entitles EB-5 investors to recover their full investment.

The SEC’s proposed rules will repeal the prohibition against general solicitation and general advertising rules for private placement offerings conducted pursuant to Rule 506 of Regulation D, *provided*:

- all purchasers are accredited investors;
- issuers take reasonable steps to verify that the purchasers are accredited investors; and
- Issuers indicate on the Form D filing that there has been general solicitation and/or general advertising.

EB-5 issuers will now be able to advertise via website advertisements, newspapers, radio, internet broadcasts and e-mail.

Most issuers of EB-5 securities rely on a suitability questionnaire to establish whether an investor qualifies as an accredited investor. The SEC has allowed issuers to rely on these representations as long as the issuer has no reason to believe that the representation is incorrect. Now, however, the EB-5 issuer will be required to take

"reasonable steps" to *verify* that the purchasers are accredited investors. It will not be good enough that a purchaser merely clams his is an accredited investor; the issuers must take “reasonable steps” to establish that the investor is in fact an accredited investor.

The SEC has made it clear that the tried and true "questionnaire practice” will no longer be sufficient. The SEC has provided examples of factors it will consider under the new rules:

- the type of accredited investor that the investor claims to be;
- the type of information the issuer has about the investor;
- the manner in which the investor was solicited to participate in the offering; and
- the terms of the offering such as the minimum investment amount.

The amount and type of information the issuer possesses about a purchaser will be a major factor in determining what other steps may be appropriate. For instance, an issuer that solicits new investors through a website accessible to the general public or through a widely disseminated email or social media solicitation will be obligated to take greater measures to verify accredited investor status than an issuer that solicits new investors from a database of pre-screened accredited investors maintained by a reliable third party, such as a registered broker-dealer.

EB-5 offerings will always be made to natural persons. They are most commonly done with a website or via email as a result of the practical challenge of soliciting purchasers outside of the U.S. Based on the proposed rules issuers will have to take more steps than before to verify the accredited investor status of investors sought via these public forums.

EB-5 issuers may want to ask for source of funds documents from prospective investors earlier rather than later—even before providing investors with a Private Placement Memorandum or Subscription Agreement. Further, EB-5 issuers will still have to consider whether the source of funds documentation is sufficient to meet the burden of the proposed "reasonable steps" requirement. For example, if an investor's source of funds is a gift, source of funds documentation will be less useful in verifying accredited investor status than if the source of funds was occasioned by a usual course of business transaction.

The SEC proposed rules stipulate that the agency will take into account whether the investment was made with cash “financed by any third party.” Conversely, if there is a high minimum amount of investment, the SEC states it may be reasonable for an issuer to

take *fewer* steps to verify accredited investor status. As always, if a purchaser provides false or fraudulent information or documentation, an EB-5 issuer will not face liability provided it did not reasonably know that the information was false or fraudulent.

Any EB-5 issuer that relies on an exemption from registration pursuant to Regulation D is required to file a Form D (Notice of Exempt Offering of Securities with the SEC) within 15 days after the first sale of securities in the offering.

The Form D discloses:

- information regarding the issuer of the securities;
- information about related persons (executive officers, directors, and promoters);
- identification of the exemption or exemptions being claimed for the offering;
- factual information about the offering, such as the duration of the offering, the type of securities offered, and any commissions or other payments to third parties in connection with the offering on behalf of the issuer.

The SEC's proposed new rules will amend the Form D to add a new check box for an issuer to indicate that it is relying on the new "Rule 506 (c)" exemption allowing general solicitation. *The SEC's view is that this disclosure will allow it to better monitor private offerings conducted using general solicitation and that purchasers in those transactions need more oversight and protection against fraudulent activities by issuers*.

Many EB-5 issuers rely on the dual protections afforded by the Regulation D and Regulation S exemptions. Dual exemptions are an effective way to reduce securities law risk, especially since the SEC has not given much guidance with respect to certain EB-5 practices.

The Regulation S "offshore exemption" has several requirements, one of which is that there should be no "directed selling efforts" within the United States. Any methods of general solicitation or general advertisement such as online advertisement (which can include posting descriptions of an offering on an EB-5 issuer's website) may be deemed to be directed sales efforts. *Insofar as these selling efforts are accessible to individuals in the United States, a regional center or other EB-5 issuer utilizing these advertisements would not be in compliance with Regulation S. Therefore, taking advantage of the*

freedom to conduct a general solicitation or general advertisement under the proposed rules relating to Regulation D may eliminate a regional center's or other EB-5 issuer's ability to rely on Regulation S.

If an EB-5 issuer conducts a general solicitation or general advertisement under the proposed rules, but does not take reasonable steps to verify the accredited investor status of proposed investors, the issuer is in danger of having no valid exemption to the registration requirement.

Regional centers and other EB-5 issuers must take significant measures to adopt policies and procedures governing how they obtain and maintain documentation regarding potential purchasers' financial information and accredited investor status. Importantly, any issuer wishing to take advantage of the new general solicitation and general advertisement rules will be required to alert the SEC of that fact on a Form D, filed shortly after the offering commences.

In conclusion, any marketing advantages sought from general solicitation and general advertisements must be weighed against the potential pitfalls of losing a securities law exemption. Some EB-5 issuers will not be best served by taking advantage of the greater marketing opportunities allowed by the new rules.

About the author: Douglas Slain graduated from Stanford Law School following a MA in intellectual history from the University of Chicago where he studied with Saul Bellow and Hannah Arendt. He founded four national monthly law reporting titles now published by Thomson-Reuters. Slain served as a rule of law consultant to the Ministry of Economy for the Republic of Latvia as its secured transactions adviser and taught at Stanford Law School as an adjunct clinical law professor. He has been a licensed real estate agent in Hawaii, a licensed real estate broker in California, and has held U.S. Security Series 22 and 63 licenses. Currently living and working in Chiang Rai, Thailand, and Mill Valley, California, Slain manages a LinkedIn discussion group with over 800 members, Securities Enforcement Reporter-Securities Enforcement Group.

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