

CLIENT UPDATE

USCIS AND SEC STAKEHOLDER ENGAGEMENT: EB-5 INVESTMENTS AND IMPLICATIONS UNDER FEDERAL SECURITIES LAW

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On April 3, 2013, USCIS and the SEC held a joint conference call to discuss what aspects of federal securities law are implicated by EB-5 Investments, as it relates to both the issuer and the investor. As a disclaimer, I am an avid supporter of the [EB-5 Investment Visa](#), and have discussed it in detail in [previous posts](#). In summary, the EB-5 Investor Visa allows foreign investors to obtain permanent residency in the United States if they invest a minimum of \$1,000,000 (or \$500,000 in a high unemployment or rural area). The permanent residency is conditioned on the success of the investment after two years and, in particular, whether the investment creates a minimum of 10 full-time jobs for American workers.

In the early 1990s, USCIS implemented a pilot program, recently extended through September 2013, which allows the creation of a so-called "Regional Center." The purpose of the Regional Center is to structure, administer, and market a project primarily funded through the pooling of EB-5 investments. In many cases, the Regional Center is also the project developer, but can be a third party as well. Each EB-5 Regional Center must be individually approved by USCIS. For example, a project developer who is developing a ski resort could form a Regional Center to solicit EB-5 investors. Typically, the investments are structured as a Limited Partnership interests, where the developer is the General Partner and the investors are Limited Partners. Garnering little attention at first, primarily due to inconsistent administration by USCIS, the pilot program recently took off after a complete overhaul of how it is administered and, specifically, the creation of a separate division in USCIS solely for adjudication of EB-5 visas.

Overview of Stakeholder Conference Call

The joint USCIS/SEC conference was primarily concerned on how Regional Centers, as well as those who solicit investments, may be subject to SEC Regulations. At the outset, the USCIS

noted that the Director of the agency has been focused on enhancing regulation and cooperation with federal agencies in the EB-5 Program. The SEC was represented by senior staff members from the following four departments: Division of Corporation Finance, Trading and Markets Division, Investment Management Division, and the Division of Enforcement.

Division of Corporation Finance

The SEC noted that the principle issue that may arise for EB-5 Regional Center is whether they trigger regulation under federal securities laws. The answer will, in virtually all cases, be yes. A threshold issue is whether the Regional Center is "transacting in securities." The definition of securities, as the SEC stressed, is very broad and includes any investment interest. The second factor, offering or selling securities in interstate commerce, is also very easily triggered—particularly considering the target investor.

What happens if an issuer of securities is "transacting in securities"? That triggers the SEC's federal registration requirements - a complex penumbra of laws that is most commonly known as "going public" or filing an IPO. There are exemptions from registration which are used by Regional Centers—such as the Private Placement exemption, Regulation D, and Regulation S. Generally speaking, these various regulations are designed for relatively small offerings or offerings made overseas.

This allows most Regional Center exemption from registering with the SEC, but does not exempt them from regulation by the SEC. This key point was reiterated several times throughout the conference call. Therefore, Offerings of investments through Regional Centers are still subject to the anti-fraud provisions of federal securities laws. Additionally, they are subject to the prohibition against general solicitation and advertising. That prohibition is so broad that includes internet posts, local newspaper articles, and everything in between.¹

Trading and Markets Division

The SEC's Trading and Market Division is primarily responsible for administering the Securities Exchange Act of 1934 (the "34 Act"). Within the context of EB-5 investments, it is focused on the status of individuals involved in the sale and offering of these investments, commonly known as Broker-Dealers. The bottom line here is that, if someone is engaged in the activity of soliciting foreign investors, it is highly likely that they are engaging in brokerage activities, therefore triggering the requirements of Broker-Dealers. The SEC noted that the commission has "approached registration on a territorial basis." Therefore, the seller or solicitor of investors will be subject to the 34 Act even if they exclusively solicit foreign investors.

What are the activities that trigger Broker-Dealer registration? Two main tests: (1) if the person is directly soliciting the investment; or (2) if the person is indirectly advertising the investment. The question in the latter situation focuses on the remuneration or compensation of the individual. If that person's compensation is tied to the number of investments, then that will be sufficient to trigger registration. The only exception here applies to natural persons (not an entity) associated with the issuer (which, in EB-5 context, is usually the developer). Even then,

¹ NOTE: the JOBS ACT, enacted last year, changes the law to allow general solicitation and advertising for exempt issuers. However, the SEC noted that, while they have drafted proposed rules, none have been implemented yet.

that person may not solicit investments if they have been a broker-dealer in the recent past or are subject to various statutory disqualifications.

Investment Management Division

The SEC's Investment Management Division regulates two main federal statutory laws: the Investment Advisers Act, and the Investment Company Act. Whether an EB-5 Investment triggers either Act depends on how the investment is structured. Most critically, these two acts usually work as a residual catch-all for federal regulation. In other words, if an entity or natural person is not a Broker-Dealer, they will most likely be an investment adviser or an investment company.

Investment companies are those commonly known as mutual funds -- they pool securities and sell ownership interests in the pool to investors. Investment advisers are just what they sound like - anyone who is in the business of providing investment advice for compensation, unless they are a Broker-Dealer.

This comprehensive regulatory scheme virtually guarantees that an EB-5 investment will be triggered by one or more of the various federal securities laws. A Regional Center, for example, may be considered an Investment Company if they meet this definition: An Issuer that holds, invests, or trades in securities. If the EB-5 investment is structured in a way where multiple investors hold a share in the investment pool of funds, which is then used to finance an underlying project that the Regional Center also owns a share in, then they are an Investment Company. Triggering the provisions of either, the Investment Company Act or the Investment Advisers Act, requires that the adviser or company register with the SEC. There is a fiduciary duty owed by the investment advisor - i.e., they must disclose conflicts of interests, any self interest in the project, and avoid self dealing.

As you might have guessed, there are limited exclusions from registration with SEC, but not from regulation by the SEC. The major exclusionary category is the so-called Professional Exclusion. This exclusion covers most attorneys, accountants, and teachers - if the advice provided is incidental to the services provided. This is a very important, but limited, exception that applies to many EB-5 providers of ancillary services, such as legal advice.

Division of Enforcement

The final part of the SEC's presentation was from the SEC's Division of Enforcement - who I like to call the "muscle" of the SEC. Fresh off the heels of its first major EB-5 related enforcement action, the Division's message could be summed up as this: if you run afoul of any of the first three divisions, you will deal with this, and we are usually not a fun time. The SEC staff member summarized the facts, allegations, and potential consequences (trial is still ongoing) of their [Enforcement Action against a formerly Chicago-based Regional Center](#); which was basically a ponzi scheme that run out of fresh investors. (More details in this previous [post](#)).

Conclusion

The EB-5 Investor Visa program, particularly investments through Regional Centers, has skyrocketed in the past couple of years. In prior years, out of the 10,000 annual visas allotted by USCIS to the program, no more than usually 3-4,000 were used. However, in FY '12, it is predicted that well over 9,000 will be utilized, perhaps even meeting the cap for the first time!

As the popularity of these investments increases, so will the potential for abuse by fraudulent individuals, which, in turn, will draw increasing regulatory scrutiny to all parties involved. Although, for a developer, use of a Regional Center to raise EB-5 funds might be very tempting, it is critical to consult with an experienced Securities Lawyer, in addition to an Immigration Lawyer.

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