

## Client Alert

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# A View of EB-5 Program Issues from a Top SEC Enforcement Official

By Daniel A. Nathan and Lawrence Bard

As participation in the U.S. Citizen and Immigration Services (USCIS) Immigrant Investor Program or “EB-5 program” grows, regulatory interest is showing a commensurate uptick. On November 20, 2013, Associate Director Stephen Cohen of the SEC’s Division of Enforcement spoke to a meeting sponsored by the Federal Bar Association about the securities law issues implicated by the EB-5 program, and about the SEC’s efforts and interest in the area.

**Current Interest:** Cohen’s principal message was that sales of interests through the EB-5 program could involve securities, and he indicated that this occasionally surprised people involved in the program. Therefore, participants should pay attention to the requirements of federal securities laws. Cohen said that the SEC is very involved in considering EB-5 activity, including two recent enforcement actions.

According to Cohen, the SEC and the USCIS have been closely coordinating on EB-5 program issues and specific investigations for at least two years. They share a particular interest in making sure that the EB-5 program is free from fraud. Indeed, both of the EB-5 enforcement actions that the SEC brought this year involved fraud. Cohen noted that one of the disclosure hot topics from the SEC’s perspective is any suggestion that USCIS has approved investments in a particular project.

The SEC and USCIS also are collaborating on programs to educate stakeholders about the EB-5 program, including a [joint teleconference](#) held last spring at which subject matter experts from the SEC’s Divisions of Corporation Finance, Trading and Markets, Investment Management, and Enforcement discussed securities law compliance in the context of EB-5 Regional Centers and investments. In addition, the agencies recently issued a [joint alert](#) to warn investors about fraudulent investment scams that exploit the EB-5 program, and issued a joint press release to announce a more recent securities fraud case brought in Texas.

**Impact on Companies:** The most obvious impact of the securities laws on offerings through the EB-5 program involves how the offerings are structured, Cohen stated. Securities lawyers are in the best position to inform a company if the fundraising activities of a Regional Center constitute the sale of securities. Cohen walked through the legal definition of security, but also provided the short-hand definition: an investment is a security if an investor’s money is put at risk in a project whose success depends on the efforts of others. The fact that the security is privately offered and does not fit the classic definition of an exchange-traded security does not mean that it is not a security..

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Once an investment is found to be a security, Cohen said, the issuer should consider if the security must be registered or if it can be privately offered. Cohen discussed often-used exemptions – those for foreign offerings and for private placements – in general terms, but provided several cautions:

- an issuer should be aware of prohibitions against general solicitation if it decides not to take advantage of Rule 506(c) under the JOBS Act permitting general solicitation;
- depending on the facts and circumstances, promoting an EB-5 investment opportunity on a company's U.S. website often raises "general solicitation" concerns; and
- under Regulation S, the general exemption for foreign sales, the purchase must take place overseas, a requirement that companies may not be adequately focused on.

**Other Securities Law Issues:** Cohen also discussed the broker-dealer, investment adviser and investment company registration issues implicated by EB-5 fundraises. With respect to broker-dealer issues, Cohen noted that there are a variety of activities not associated with conventional stock brokerage activity that could require a Regional Center or other participant in an EB-5 fundraiser to register as a broker-dealer. These include:

- soliciting someone to purchase or sell one or more securities (including by advertising);
- helping an issuer identify potential purchasers of securities;
- screening potential purchasers of securities;
- negotiating between the issuer and the investor;
- participating in the order-taking or order-routing process;
- handling customer funds and securities;
- making valuations as to the merits of an investment or giving advice;
- acting as a finder, that is, putting potential buyers and sellers in touch with each other for a fee; and
- acting as a private placement agent.

A key factor as to whether someone is acting as a broker-dealer is the receipt of a transaction-based fee or a success fee. Indeed, Cohen pointed out that these considerations could apply to an attorney who is paid by a Regional Center to find investors. Cohen indicated that the SEC routinely brings cases involving unregistered broker-dealer activity and, while he has not yet seen any cases involving unregistered broker-dealers in the EB-5 context, it is a priority area for the SEC.

Cohen also said that similar registration issues could exist if a Regional Center acts as an investment adviser. Among other things, an investment adviser is a person who, for compensation, advises others as to the advisability of investing in securities. Thus, he said, a Regional Center that recommends that a customer invest in an EB-5 project could fall within the definition of an investment adviser.

In addition, Cohen touched on some of the investment company issues implicated by EB-5 offerings. Often, he said, investors' funds are pooled in an entity that sells securities. Unless the company can avail itself of an

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exemption from the definition of “investment company” under the Investment Company Act of 1940, it could be required to register as an investment company.

**The Takeaway:** So far, the SEC’s enforcement actions involving the EB-5 program have involved fraudulent schemes, but the agency’s increasing focus in this area might mean that the next enforcement actions will involve more traditional regulatory issues, such as securities and broker-dealer registration. Therefore, those involved in development projects that raise funds through the EB-5 program should be cognizant of the securities law issues implicated by these projects.

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