

ADVENT OF THE EB-5 BROKER-DEALER



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WHAT IS A BROKER-DEALER?

Broker-dealers serve an important role in U.S. financial markets to ensure integrity and transparency. Broker-dealers are registered with the Securities and Exchange Commission (SEC) and are members of the Financial Industry Regulatory Authority (FINRA), each of which provides regulatory oversight. In addition to conducting independent due diligence on companies seeking capital, the broker-dealer has a duty to only offer “suitable” investments to potential investors. In other words, each investment offered by a broker-dealer must be suitable for that investor in light of their: (1) stated investment objectives, (2) risk tolerance, (3) liquidity needs, (4) investment experience and (5) investment time horizon.

For an EB-5 investor, “suitability” carries additional immigration burdens. EB-5 investors seek to obtain immigration status within the U.S., which adds a component to their investment goals not present with traditional investors. The feasibility of the immigration goals must be evaluated as part of the diligence process just as closely as the financial soundness of a project. Accordingly, EB-5 broker-dealers must obtain additional FINRA approvals before they can raise money from investors for EB-5 projects.

RECENT SEC ACTIONS

The September 2016 Government Accountability Office (GAO) report identified that the

most frequent incidents of fraud in the EB-5 program are associated with securities fraud, whereby immigrant investors were defrauded by unscrupulous regional center principals, developers and/or their associates. Recent enforcement actions brought by the SEC underscores this trend.

According to the SEC, between February of 2013 and December of 2015, the Commission filed 19 cases involving EB-5 offerings, of which almost half (7 cases) involved fraud allegations. Additionally, 11 of the 19 cases involved unregistered persons acting as broker-dealers.

The SEC brought forth the first stand-alone unregistered broker-dealer case in the EB-5 industry in June of 2015. The case involved two firms claiming to help investors choose the right regional center, but in fact the firms directed most of the EB-5 investors to regional centers paying the firms commissions of roughly \$35,000 per investor. The firms handled EB-5 investments for more than 150 investors.

The most recent SEC enforcement actions against Pacific Proton Therapy Regional Center and the sponsors of the Jay Peak project in Vermont share elements that are common in fraud cases. In these and other instances of investor fraud, (1) there was no independent verification of the claims made by the project sponsors and (2) there were no independent controls on the management of investor funds. EB-5 investors trusted the assertions

of the parties raising the money about the status of the project, and once the money was in the company’s account, no safeguards were in place to control how the money would be spent.

BENEFITS TO EB-5 INVESTORS

Intentional or not, these situations are more likely avoided when working with a FINRA licensed broker-dealer, largely because of the independent and thorough due diligence conducted by the broker-dealer. This includes conducting background and credit checks on key personnel, evaluating third-party valuations and feasibility studies, conducting site visits, reviewing significant contracts and agreements, confirming the status of the necessary approvals (permitting, zoning, etc.) for the project and critically evaluating the job projection study. The independent investigation of the EB-5 offering provides investors an elevated level of comfort that the offering has been vetted by a securities professional. This may also give project sponsors and immigration agents a marketing benefit with investors, as projects sold by a broker-dealer carry the weight of an institutional third party validation.

In addition, some EB-5 broker-dealers insist (or strongly encourage) that EB-5 projects retain a third party manager of the New Commercial Enterprise (NCE) to oversee the release of capital to the project and verify that the capital is being used for authorized expenditures.

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BENEFITS TO PROJECT SPONSORS

Although the “peace of mind” benefit to investors discussed above may be compelling to some, arguably the biggest beneficiary of an EB-5 broker-dealer is the project sponsor. Even in the absence of fraud, project sponsors may one day find themselves dealing with disgruntled EB-5 investors.

Legitimate projects can have issues that arise from development delays, changes to the business plan or perhaps operational shortcomings. Absent fraud, the burden of handling such issues becomes the responsibility of the broker-dealer that sold the investment. In the event of a dispute, the broker-dealer must demonstrate that they conducted proper due diligence and that the investment was “suitable” for the investor. This aligns the project sponsor and the broker-dealer and provides the project sponsor with an additional defense against investor claims. Using a broker-dealer reduces the potential for investors to prevail on a claim of recession (in which they would get their money back from the project sponsors) or class action lawsuits. When an investor is a customer of the broker-dealer, all disputes are handled by a FINRA arbitration panel trained to deal with complex financial instruments and offerings. This means that any dispute (outside of fraud) will likely be isolated and handled more quickly, efficiently and confidentially than if the dispute were litigated in court.

Another benefit to project sponsors is increased confidence that the capital raised is compliant with state and federal exemptions under the securities laws. Most EB-5 offerings are done under the Regulation S and/or the Regulation D exemptions.

To qualify under Regulation S, the offering must meet two conditions: (1) the offer or sale is made as part of an “offshore transaction” and (2) none of the parties make any “directed selling efforts” in the United States. To qualify under Regulation D, the offering must: (1) be made primarily to accredited investors that meet certain income or net worth thresholds, and (2) not have been marketed as a general solicitation (i.e., mass advertising), unless the “accredited” status of every investor is verified with credible documentation. Since each investor is a customer of a broker-dealer, the broker-dealer is in a position to confirm and verify that the factual requirements necessary to ensure compliance with the offering’s relevant exemption(s). The broker-dealer is required to maintain these records in compliance with FINRA regulations.

To be clear, marketing an EB-5 investment under a Regulation D or Regulation S is an exemption from registration, and does not exempt a project sponsor from following other federal or state securities laws. For example, EB-5 offerings must have a comprehensive disclosure document (i.e., Private Placement Memorandum) that satisfies the sponsor’s “an-

ti-fraud” obligation.

Broker-dealers, as part of their due diligence review, carefully examine the Private Placement Memorandum and other documents provided to investors, with the goal of fostering compliance. In addition, no project sponsor can legally pay transaction-based compensation to agents or finders who conduct any activity in the U.S. and are not registered with FINRA. The SEC has refused to issue ‘no action letters’ protecting the current industry practice of paying transaction-based compensation to foreign persons selling EB-5 offerings under the Regulation S exemption, thus preserving the right of the SEC to enforce rules that prohibit the payment of transaction-based compensation to unlicensed foreign persons.

In conclusion, working with a broker-dealer can provide several benefits to both investors and project sponsors. Investors may take comfort in the FINRA regulations that require broker-dealers to (i) vet the offerings they bring to market and (ii) confirm that the offering is suitable for the investor. Project sponsors may take comfort in the FINRA regulations that require broker dealers to (i) confirm each investor meets exemption requirements, and (ii) review the offering documents with the goal of improving compliance. These benefits should give greater “peace of mind” to investors and project sponsors in offerings in which a broker-dealer is involved. ■

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Clem Turner is a partner in Barst Mukamal & Kleiner LLP, the one of the oldest immigration law firms in the United States, where he leads the Corporate and Securities Practice. Mr. Turner has significant experience in immigration investment, venture capital, securities law, general business and corporate counseling. He has counseled numerous corporations and Regional Centers raising capital through the EB-5 Program on matters of structuring, strategy, securities law and corporate law. Mr. Turner is a respected member of the EB-5 trade association, “Invest in the USA” (IIUSA), and currently serves on its Public Policy Committee and Chairs its Securities Law Sub-Committee. Mr. Turner has been selected multiple times as a “Top 25 EB-5 Attorney” by EB-5 Investors magazine.

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Michael Fitzpatrick has been with Baker Tilly since 2000 and is a partner leading the EB-5 investment practice. Baker Tilly Capital, LLC is a member of FINRA specializing in EB-5 investments, merger and acquisition, capital sourcing, project finance and corporate finance advisory services. Baker Tilly Capital, LLC is a wholly-owned subsidiary of Baker Tilly Virchow Krause, LLP, a national accounting and advisory firm with approximately 2,700 employees across the United States and independent member of Baker Tilly International, which is the ninth largest global network of accounting firms with members in 147 countries.