



# Risks for Regional Centers and Project Principals in Accepting “Politically Exposed Persons” (PEPs) as Investors



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**A**s lawmakers focus increasingly on compliance and integrity in the EB-5 Program, regional centers and principals of EB-5 projects or EB-5 funding entities should implement policies and controls to prevent the acceptance of funds that could include proceeds from money laundering or corruption. One compliance measure that regional centers, issuers in transactions and recipients of EB-5 capital may take is to implement risk-based screenings for applicants that are politically exposed persons (PEPs). Such screens would allow potential investors to invest in a project sponsored by or affiliated with a regional center only if heightened due diligence can be performed, and after any potential corruption issues discovered therein have been resolved. This is an important issue for EB-5 regional centers as efforts to raise capital continue across borders, especially in countries where corruption is reported to be commonplace such as Vietnam, India, Brazil, Turkey and Venezuela.

## WHAT IS A PEP?

Generally, PEPs are individuals who pose a

perceived higher risk for money laundering because of their prominent position or influence. The term is used commonly in the banking context, where financial institutions and broker-dealers are required to comply with anti-money laundering (AML) laws that mandate having risk-based screens in place to identify PEPs. The term PEP has also gained traction globally in efforts to develop standards to combat money laundering and the financing of terrorism. The term does not refer exclusively to a politician or political figure.

A PEP may be a current or former foreign government or military official, a senior executive of a foreign government-owned corporation, a government minister or official, or a family member (e.g., parents, siblings, spouse, children, and in-laws) or close associate of any such individual. Other examples include judicial officials, Heads of State, or senior politicians or important political party officials, as well as their family members and close associates.

PEPs are not barred from participating in the EB-5 program, but they must be carefully screened as they are considered more likely to

pose risks of money laundering of proceeds from corruption and/or other illegal activities. In other words, enhanced due diligence may be required with individuals who are potentially PEPs. In general, the issuer in an EB-5 transaction or a broker-dealer representing the issuer would ensure that such due diligence is completed. This due diligence is not automatically performed by a bank or escrow agent.

## PEP SCREENING SHOULD BE PART OF A BROADER EB-5 COMPLIANCE PROGRAM

Before transacting business with a potential PEP, a regional center, funding entity selling securities to EB-5 investors, or an EB-5 project principal should undertake due diligence to understand the risks of accepting such an investor. This process can be outsourced to a broker-dealer, a qualified anti-corruption lawyer or compliance professional, or other vendor with expertise in AML and fraud detection. Depending on the circumstances, potential resources include global accounting and investigative firms with regional expertise

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in a specific geography, and local vendors capable of providing investigative, research, and analytical services and due diligence reports. The due diligence should not be performed by any party with a financial interest in the investment being accepted, but should be undertaken by a disinterested and qualified party who has experience with anti-corruption investigations.

The breadth and focus of due diligence efforts necessary for a particular investor who may be a PEP depend heavily on the facts and circumstances surrounding the investment and source of funds. For any potential investor who may be deemed to be a PEP, a regional center, issuer or project principal should review a report on that individual that highlights any “red flags,” even if the source of the investor’s funds for an EB-5 investment are purportedly from a lawful source. These “red flags” could include negative press or media attention, unexplained or inexplicably complex routing or origin of investment funds, use of secrecy vehicles or havens, consulting or import/export arrangements without legitimate business purposes, potential indicators of tax or currency control evasion, or facts that a prospective investor did not initially disclose such as a close familial tie to a government official. A regional center, issuer or project principal should engage counsel to review the risk level of allowing the individual to become an investor in the offering.

In any case involving a potential PEP, the recipient of EB-5 proceeds should secure a detailed report about the investor’s background, along with advice from qualified securities, anti-corruption and banking counsel on the risks that would be assumed by accepting the investor into a regional center EB-5 offering. In some prospective investment scenarios, economic sanctions should be reviewed. These compliance steps should be documented and retained in the event of a government investigation. In an EB-5 transaction where a regional center controls an EB-5 funding vehicle such as a limited partnership or LLC, the regional center should retain this documentation. Where a regional center has an affiliation with a project but is expressly not an issuer from a securities law standpoint in an EB-5 transaction, the regional center’s principals should secure confirmation that the issuer has taken sufficient compliance steps to prevent ineligible PEPs from investing in an offering.

### RISKS AND CONSEQUENCES OF ACCEPTING FUNDS FROM A PEP

Having undetected or unscreened PEPs in a deal can expose an EB-5 regional center to invasive investigations, enforcement proceedings and costly litigation, such as forfeiture proceedings. This may result in reputational harm to a regional center, delays in closing and settlement of investment transactions, penalties and, in some circumstances, criminal exposure, in addition to legal fees. The risk level to a regional center is amplified when, after an investment is transacted and an EB-5 investor has wired funds to an escrow account or project, a regional center discovers that an EB-5 investment was acquired with funds that are traceable to unlawful activities. In such a case, funds may not simply be returned to the investor. Securities and banking law counsel should be consulted on the appropriate steps to take, which could in certain scenarios include turning the funds over to a court for an interpleader proceeding. Accepting funds from a PEP who is not qualified to become an investor can have consequences and result in costly litigation.

For example, in 2015 the United States District Court in the Eastern District of Pennsylvania (Philadelphia) ordered a default judgment against an interest in a limited partnership connected with an EB-5 investment. See *United States of America v. A Limited Partnership Interest Held in the Name of or for the Benefit of Sang Ah Park in the Philadelphia U.S. Immigration Fund, No. 2:15-CV-00814-AB (“U.S. vs. Philadelphia US Immigration Fund”)*. The action was brought by the Criminal Division of the United States Department of Justice (DOJ), which sought forfeiture. In this case, the EB-5 investor was the daughter-in-law of former President Chun Doo-hwan of Korea (President Chun), who had made an investment into a regional center project with funds traceable to corruption proceeds. The entire \$500,000 investment was ordered forfeited.

While the actual issuer of an investment in an EB-5 transaction faces the most serious consequences of accepting funds from an investor who is a problematic PEP, parties in an EB-5 transaction who later receive proceeds sourced by a PEP may face exposure in litigation. Specifically, a regional center that has only a contractual affiliation with a project, as well as an ultimate recipient of EB-5 funds such as a developer, could be named as relief

defendants in litigation. Such parties could also face reputational harm from negative media, scrutiny by government agencies and entanglement in criminal investigations. Therefore, all recipients of EB-5 capital and a regional center in an EB-5 transaction should take steps to ensure that a sufficient compliance process is in place before accepting subscriptions from investors.

### REGIONAL CENTERS CAN MITIGATE THE RISKS AND AVOID BUSINESS WITH PERSONS WHO ARE POLITICALLY EXPOSED

As we move into an era of more compliance, regional centers will need to insulate their offerings from actions similar to *U.S. vs. Philadelphia US Immigration Fund*. One basic step is ensuring that investor questionnaires in the subscription process adequately prompt investors to disclose material information on their family background.

We should presume that the Securities and Exchange Commission (SEC), the U.S. Department of Justice (DOJ), law enforcement agencies and other regulatory bodies would take a broad and inclusive definition of who may potentially be politically exposed. But not all PEPs present the same level of risk to parties in a regional center EB-5 transaction. The degree of risk is related to geographic location and the level of corruption in a specific country or industry, as well as to the position and influence of the individual.

Regional centers that raise funds without a broker-dealer have a higher risk of accepting funds from PEPs without any due diligence from a third-party. Why? Because broker-dealers must have AML programs under FINRA, Treasury and SEC rules. Issuers of EB-5 securities that do not have an affiliation with a broker-dealer should consider creating their own AML program that includes a process for identifying investors who may be deemed PEPs. Broadly, AML programs may include a system of internal policies, procedures and controls; a designated compliance officer with day-to-day oversight over the AML program; an ongoing employee training program; and/or an independent audit function to test the AML program. Having a robust AML program in place now is also a strong approach to preparing for any EB-5 integrity measures that lawmakers may introduce in connection with extending the EB-5 Program. ■