EB-5 Investment Report Interview with Michael Gibson

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USAdvisors.org's Michael Gibson discusses the importance of due diligence, how investors can protect themselves from bad projects, the latest hot topics in the EB-5 industry, transparency, and immigration broker fees during his interview with *EB-5 Investment Report Magazine*.

Aimee Rios: Hello and welcome to *EB-5 Investment Report's Dialogue Series*. Today, we are joined by Michael Gibson, managing director of USAdvisors.org, a source of information on the EB-5 program. U.S. Advisors is comprised of financial analysts, economists, accountants and mathematicians that analyze all aspects of EB-5 projects from job creation methodology to exit strategies. Recently, U.S. Advisors launched their latest platform, EB-5M.com, providing research and due diligence for foreign investors on projects in the U.S.

In Michael's interview, we discuss the importance of due diligence, how it relates to the lawsuits that have recently made headlines, and what investors can do to ensure their project is on the right track. Also, we will talk about the hottest topic today in EB-5, transparency, and immigration broker fees. Welcome to the show, Michael.

Michael Gibson: Thank you, Aimee. Thank you for inviting me.

Rios: Can you tell us a little bit about your background and about your website and your new website that you just recently launched?

Gibson: U.S. Advisors really stems from my experience working with Citicorp. I was with Citicorp Capital Markets for a number of years, primarily working emerging markets. I was doing mostly fixed income and some derivatives, hedging, trading. We were managing the risk for the bank, managing the risk for our clients. We did a lot of funding, large-project funding for some very large, sovereign states. I was in the Middle East, Latin America and Africa, and I learned a lot about managing our risk for the bank, as well as for our clients' risk.

When I left Citibank, I was looking for something to do, and I happened to meet an immigration attorney and she explained about this program, and asked with my background would I be able to look at some of the projects. This was in 2006. At the time, there were only 13 regional centers, and I believe there were four or five different projects in the market.

I had to look and I saw some issues, some concerns that I had with, again, using my background at the bank, and I explained those to her, and she said, "Would you mind giving us some more insight?" And I said, "Really, probably, the only way I can actually do this is to go onsite for a visit and meet with the developers," because at that time there was not a lot of information. There was not the investment report. There were no trade associations. There were no EB-5 conferences.

There was really very little information in the market as to who the developers were, what they were

doing, and the offering documents were horrible. The business plans were a nightmare. Some of them didn't even have business plans, so I felt the only way we could do a proper risk assessment was to go on site and meet with the developers and control persons, and see what it is they were actually proposing to do with the capital they were gonna raise, both EB-5 and more traditional sources of financing, such as a bank loan.

I went around the United States – this was in 2007 – and I visited all of the regional centers at that time. The trip took about three months' time in total going from east to west and across the country, and I filmed all of those projects. I think that experience – at the time, I finished over 18 regional centers – the experience showed me that the EB-5 program is a fantastic program for developers raising capital, for the investors who are gonna get their green card.

At the same time, I saw there was a huge amount of lack of information on what the projects were trying to accomplish, their goals, and certainly information that was not getting to the investors. I decided at that point to form U.S. Advisors as a way to facilitate the flow of information, the risk analysis, the due diligence, not only for the investors but for the attorneys who are seeking guidance on which projects were out there and how safe the projects were to accomplish their goals.

Rios: Can you tell us about EB-5M that you just launched?

Gibson: Long story short, fast-forward from 2007 to 2013. The industry has matured tremendously and now approaching close to 300 regional centers. At any point in time in the market, there's probably between 30 to 50 projects being offered, all different sizes, shapes, different asset classes, different industry groups, and the problem is, for anybody in the industry, there's just simply no one source for information.

What we have done, we have approached several regional centers, broker dealers, FINRA-registered broker dealers and others in the industry to say, "Would you mind sharing information with us on what your projects are? And would you mind allowing people to access that information?"

We have put together this platform, which, essentially, the way I describe it, the analogy I use is similar to one that we had in fixed income. When I first started with Citicorp in the 1980s, we didn't have a fixed-income trading system. We used Reuters and Telerate terminals to get pricing information, but there was no way to analyze all of the different CUSIPs and the fixed-income issues.

Bloomberg finally came out with his machine, and he licensed the technology to Citibank, so we were able to use that to do our pricing and risk analysis, and I'm using that same analogy. Our EB-5M.com platform is similar to the Bloomberg in that it will allow for everybody in the industry, whether they're issuers, they're attorneys, they're investors, they're agents, to log onto the system, see what all of the different projects are in the market, and there'll be some general information about the projects, and depending on the issuer, they can upload more or less, so according to how comfortable they feel releasing information to the industry.

The point is it's a central processing place so people cannot only find out information about the different projects, but they can also act on that. They can actually subscribe. Since this is going through a registered broker-dealer, all of the people who access that information will have to be vetted.

There are three things we will do – the "know your client," so we know who they are and some background information. We can determine that that person is actually the person who's accessing the information. We're going do the accreditation test, so we'll know if they're accredited or non-accredited, and

we'll do the suitability to ensure they are aware that these are liquid instruments and that they're suitable for investing in these instruments.

Rios: Michael, due diligence is a word that comes up often. It sounds like your website is helping those involved in the industry do their due diligence. For our viewers, can you explain what "due diligence" is and why it's so important?

Gibson: Right. Essentially, what we try to do, when somebody sees the offering package, it's quite comprehensive. If we had one on the table, it would be several inches high and weigh several pounds – maybe 10 or 20 pounds – because in there, you're gonna have all of – typically, in an offering package, you have a limited partnership agreement. You have a private-placement memorandum. You have a business plan, which may be detailed, and you are gonna have also the economic impact analysis, and there may be additional information on top of that. What we try to do is go through all of these offering documents and provide the investors with the material information they would need to make an investment decision.

"Due diligence," the way we look at it, is uncovering not only the information, which is in the offering documents, but also looking at the markets. All of these projects are building or doing something with the capital, and typically, we see about 70 or 80 percent are building some sort of commercial real estate property. So what we will want to determine is, in that market that they're building the asset for, whether it's a hotel, a casino, a shopping center or a redevelopment of any of these, we want to see, "What is the appetite in that market for this asset? What are the vacancy rates? What is the absorption rates? What is the demand in that?"

If they build it, it's not like the movie where, "If you build it, they will come." In many cases, we're seeing projects that are being developed for which we do not see a market need. And another concern is that when we see the projected pro formas, the cash flows, and the revenue projections, what we're seeing is a mismatch between what they're projected and what the market is actually showing to pay for these for whatever the asset is.

I think from our standpoint, we look at due diligence as all the information that you would need to make a decision on whether that's a suitable investment for EB-5 purposes, and that includes analyzing what the business plan says. And we have additional constraints because all of these materials have to be compliant

with USCIS requirements.

In addition to being a good investment, we need to make sure, "Are they Matter of Ho compliant? Do they follow with all of the new and old USCIS guidelines regarding the job creation and the artificial constraints imposed on the job creation timeline?"

What we need to see is, "Will the asset be performing? Will it stabilize? And will it do it in sufficient time to give the investors everything that they need so that they can file to remove the conditions at I-829 stage?"

Rios: How important is it for regional centers and developers who receive EB-5 financing to be truthful and provide accurate information about their proposed projects? And what happens to regional centers and their developers who fraudulently make material misrepresentations about their projects?

Gibson: I think it's a great question. Again, we're not a law firm, so we can't give legal advice, but what we would say from the investment standpoint is that as long as you're truthful and honest with your investors – and that includes the marketing agents, and I think this is the disconnect in our industry – I think, by and large, the developers are quite open about their projects and the risks that are entailed. And in fact, in the PPMs, you will see a risk-disclosure section, which is usually fairly comprehensive.

I think the problem in our industry is that it is handed off to a third party, a marketing agent, who may not have, say, the same constraints, and they feel – well, not only do they feel, but they're being compensated to sell product. So my sense is that these marketing agents, whether they're here in the United States or offshore, they have an incentive to not disclose a risk because if I tell you I want to sell you a car, and I tell you the wheels may not work all that well, the trunk may not work, the engine doesn't start all the time when it's cold, if I tell you these things, you won't buy the car.

Unfortunately, I think this lack of material disclosure to the investors about the risks involved in the investment, and we have to remember that in the world of private placement or private equity, these are among the most liquid investments you can make. So where you have publicly-traded instruments, like the stock exchange or commodities and futures, you can get in and out of those markets multiple times in a minute.

If you buy a house, you can turn around and sell that right away. You may not get what you paid for it, but it's a very liquid market. Same with almost any other asset. These private-placement offerings, once you're in, you're usually in for a period of time – maybe six years to eight or even longer. There are some investors who are 10 years in these instruments, and they can't get out.

The problem is that when the agents do not fully disclose the risk to the investors, and the investors invest thinking there isn't going to be a problem. In fact, I've heard, overseas, where there is discussion of guarantees and other things, when something goes wrong in the investment, I think, at that point, you're going to find that the investor is going to look not to the marketing agent for relief, but they're gonna come back to the developer and/or the issuer and say, "We were told this, this, and that, and this was our understanding."

And the developer may, then, have some issues to deal with – some legal issues to deal with if they are to either make that investor hold or to come up with other sources of capital if there is something like rescission, where they may have to return the capital invested to these limited partners. I think it brings up

a whole host of issues for the developer if they're not keeping a close eye on what the marketing agent is saying.

Rios: Michael, going along those lines, our research shows that as early as November 2011, you started reporting on this huge Chicago EB-5 multi-hotel project that was reported under scrutiny by investors. Can you tell us why that showed up on your radar?

Gibson*:* It was brought to our attention by some investors who were looking to invest in the project. At that time, it was probably the most heavily marketed project in China, so it was on our radar screens. People in China were saying to us, "What do you think about this?" This is not only the largest project being marketed at the time, but it was also the one paying the highest commissions.

So there were, I think, at least two dozen or more migration agents in China promoting this project, and we were sent the offering documents. It didn't take us very long, a few hours to realize that this was all nonsense. There was no substance to anything that they were claiming or promoting in the marketing material, and it was more disturbing because it wasn't just the marketing material from the centers, from

the regional center that was of concern – that was very troubling when you looked at it – but then when you looked at what all the agents were saying on top of that – the additional guarantees and claims and things that were simply not true.

We went through all of the claims that were being asserted, and we found that – typically, you're gonna find problems with one or two – maybe a couple of areas where there could be some doubt as to what might be accurate or not. But we found in this case nothing that he said was factual, so we reported on that, and we thought that would be the end of it – not that everybody in China reads our blog, but we thought, certainly, anybody who spent a few hours doing some level of due diligence would find out that none of the things that they were claiming were true.

And yet two years later, we found that the project was still being marketed, and we were actually in the process of writing a follow-up just as the time of the SEC action happened. While that took the industry by surprise, I don't think anybody who spent just even a few hours looking at the documents would've been surprised.

Rios: Now, where did the investors fail on that – not doing their due diligence? How did this happen?

Gibson: This was easy. There was no due diligence done by anybody. I don't think the state of Illinois, who had the governor on stage presenting with the developer. They certainly had no idea.

I mean you don't even need to do a site visit. As I say, in most cases, we do site visits. I think anybody who had done a site visit or even a Google search would've seen there is no possible way that they can make a convention center that is not only not anywhere near downtown but not even near the airport. It's in the middle of nowhere out by O'Hare in a small – I think it's a 3.1-acre parcel, and they were gonna put five hotels there. The whole thing was fantasy, so I don't know anybody involved in that chain, whether they were the attorneys or the agents or the service providers, I don't think anybody did any level of due diligence whatsoever.

Rios: It turns out that your concerns were right about the Intercontinental Trust of Chicago, and February 2013, the SEC filed a civil complaint against that regional center and its founder for securities fraud. So why does the SEC often refer to Sethi, the founder of this project, as the "14-year-old developer"?

Gibson: In one of the claims that he made, which was outstanding – and again, this is where I blame the U.S. service providers because I can see how the Chinese investors don't know. They don't know where Chicago is, much less this small-acre parcel outside of O'Hare. I understand how the Chinese investors do not understand that you cannot fit five hotels onto a small block, and that there isn't a $300 million sovereign commitment from a foreign entity or any of the other claims that were being made.

But the U.S. service providers, and there were at least, I'm going to say, probably a dozen people on the U.S. side – attorneys and other economists and other service providers who touched this deal who are involved in this and, to some extent, supported the deal. At least, if not by going to China and making public support statements, they supported it by doing some service for this offering, and then the developer used that, their logos or their experience in their firm, to show the investors that, "Don't believe what we're saying. Look at what these firms are saying. They trust what we're saying, and they've done the work."

On the U.S. side, there is a problem in that there is a lack of due diligence on the client engagement. You have attorneys and economists and others who will simply engage with almost any client regardless of the claim. One of the claims that the SEC was referring to was where Sethi had claimed that he, I think, had 15 years of commercial construction development experience, and he was only 29.

If you do the math, he would've been 14 when he started, which, again, when we review offering documents, we oftentimes find discrepancies between what the developer may be claiming and what the market may be supporting, as Ronald Reagan would say, "Trust but verify." It's not that we don't trust what the developer is saying, but when we verify the facts, some things don't add up.

And in this case, on the U.S. side, the people who provided service to Sethi and the others in his group, I think they may have been misled. But at the same time, I think it's their own proper responsibility, not only for their firms but then down the road for the investors who may – in the case, they didn't lose that much money, but for those who do, they may come looking for relief to them because they supported that engagement. And I think if you look at some of these statements, you would just, at the inception, say, "There is no possible way."

Rios: Now, there was another project – company that I read about in one of your newsletters. It was the Neogenix Oncology. Can you explain that? And can you tell us what lesson can be learned when raising capital and dealing with finders' fees regarding this?

Gibson: This is an issue, I think, in our industry that is going to be probably more problematic as we go forward, and I think the case of Neogenix is a good warning sign for people who are raising capital and doing that by paying third parties who may not be registered. The issues with Neogenix was that they used a U.S.-based finder to raise a significant amount of capital. What happened, then, was the CPA firm who was doing the audits of their financial records would not sign off because they were concerned that the payments of fees to non-registered persons could invoke something called "rescission," meaning that Neogenix might have to return the capital back to the investors by paying a third party.

It was pretty clear that the third party was a broker in that transaction. Whether he had to be registered or not could be a matter of some debate, but I think the SEC's view is that anybody paid a commission in the sale of a security should be registered. In this case, the CPA firm would not sign off on the financials if they did not include a note in there saying that there is a possibility of rescission. All of the capital may have to be returned.

This caused a delay in the filing of their quarterly statement, and this delay in the filing – this was a fairly liquid company. They relied it on the pink sheets, which is an over-the-counter trading system. When this came out – the delay in the filing and the reason why the filing was delayed – it actually put the company into bankruptcy.

I think the lesson we can learn here is that as the SEC becomes more involved in other – it's not just the federal government but the state governments, where here in California, the State of California has a very active securities enforcement division, where our offices based in Florida, we have an equally strong enforcement. New York, Texas – some of these states' securities regulators are looking into this payment activity finder. In Florida, we have a lot of problems because these finders are raising capital, and they're putting them into things like Ponzi schemes.

What we're seeing is more concern from the regulatory standpoint that these finders may be doing things

that are not legal. I think in the case where the investors then find faults, for whatever reason, in either the investment – they're not happy with what happened.

For instance, in EB-5, perhaps, they didn't get their green card, the conditions removed at 829, and they find out that a third party, non-registered person was compensated, was paid finders' fees in the raise. They could, then, theoretically, hire an attorney and ask the principles to return their capital because the exemption – the Reg. D or the Reg. S exemption – was violated. Violating the exemption provisions, which may include not paying third parties who are not registered, could be a problem for people raising capital in the EB-5 space.

Rios: Now, how can investors protect themselves from being caught up in lawsuits and bad projects like we discussed? And how important is it for the investors to have an exit strategy?

Gibson: I'm going to take a step back because I don't know that we can rely on these investors to do a whole lot. By and large, these people, while they're very intelligent, and they have been very successful, they are not sophisticated investment analysts or experts.

I have the expectation that investors really don't know what it is that they're doing, and in our industry, I take a bit of an issue with the – especially the immigration attorneys who are not recognizing this. I think they're assuming that their clients are sophisticated. They may be, technically, by the securities definition. They may be accredited, and they may have signed off that they're sophisticated, but by and large, the investors are not. They do not understand the illiquidity and the risks involved in commercial real estate development or any number of other asset classes – commodity extraction, manufacturing.

Our viewpoint is our clients are not sophisticated, so it's our job to explain to them in as much detail as we can what all the risks are involved in these investments so they can make a better-informed decision. But I think that step is skipped in most cases, and I think the fault I would place firmly at the foot of the immigration attorneys who may not be giving their clients sufficient guidance. Now, they may say, "We won't give them investment guidance."

But then they should find somebody who can give them, whether they're another investment advisory firm or a CPA or somebody who's an expert in that industry, to guide them because, unfortunately, I think what's going to happen is these clients, if they do make an investment and it turns out to be a poor choice, they're going to look to the immigration attorney for relief. So for the immigration attorneys who may be watching this, I would guide them to get as much second-, third-party opinion on these investments because the investor, if they lose their money or they lose the petition for residency, are going to be very upset, and I EB-5think they're gonna look to them for relief.

Rios: Michael, recently CIS hosted a stakeholders' conference with SEC, do you agree with SEC's latest guidelines that immigration brokers directly associated with EB-5 regional centers who are operating within the U.S. and abroad are required to be registered security brokers?

Gibson: That's a great interesting question and I'm going to leave the debate really up to the securities attorneys. I'm probably not qualified to answer that. But having studied for a number of these exams both with Citicorp and now with my present firm, my sense is that yes, they need to be registered.

When you go through and you look at the 1933, the 1934, and the 1940 Acts it seems very clear that not only the people involved in the securities transaction, whether they are a registered representative, meaning they work for a broker/dealer and they are involved in the sales of securities, or an investment advisor is what I am, they need to be 1) registered because the whole reason the SEC was formed and these laws were implemented was because just before the Great Depression there was a huge amount of fraud and malfeasance in the securities industry, and these laws passed to protect the investor.

In fact, if you go to the Securities and Exchange website you will see their primary mandate is to protect the investor. Their secondary function is to create efficient markets to raise capital, but their primary function is to protect the investors.

That's why these laws were passed. The laws, they're not nonsense laws. They have a reason. And the reason is because what we see, and this has been going on for decades since the 1930s, is that when unregistered persons get involved in a market – and this isn't unique to EB-5. There's been problems in the hedge fund industry and other forms of private equity raises, even in the public securities markets.

When you have unregistered persons getting in and raising capital and telling things to investors that are not true, harm comes, and the problem is there's no remedy for the investors because these are unlicensed people.

We have a very strict code of conduct. We're subject to FINRA Audits. There's a quite comprehensive examination process. There's a lot of things that we as registered people have to do and there's a reason we have to do it.

Their concern is, you see an entire industry that is using unregistered persons and firms to raise capital. We understand the need to raise capital, but the registration process is not that hard to do. There are some requirements, the exams and the registration, but the reason for doing that is to protect the investor.

I think the SEC, now that they've come involved with this industry, they're issuing some guidelines, some education to let the people know who are either raising capital or who are in that finder industry, consultants and finders, become registered so that you abide by the same laws that everybody else does in the rest of the capital markets. I think by doing so we only strengthen the industry. It's's a best practice.

In fact, what I would say, even if you're not certain, even if you as a person raising capital are not clear as to whether you need a registered person or not, I would say simply it would be a best practice. It would be something that you would, really if you involved registered persons in your raise, you would be showing the investor that you have due care and concern for their well-being.

I think by the people, the regional centers, and others who are raising capital using unregistered persons they're effectively saying to the investors, not that we don't care about you, but we don't care, we don't agree with the U.S. securities law and we're just going to take the chance that you don't need to be registered, and we're going to use your services. I think that way of thinking is fine for the old days, but if we want the industry to grow, to double the size of the amount of capital raise, I think we have to conform with the way the rest of the capital markets work, and that's by using registered persons in the raise.

Rios: Now it's our understanding that the larger Chinese immigration brokers maintain active offices in the United States. Are these types of immigration brokers who have offices in the U.S. possibly violating U.S. security laws? You touched upon that a little bit.

Gibson: Okay, so again, we cannot give guidance because we're not on the regulatory side, but if you read the Acts and you go through the regulations, and you also, it's not only the written laws but you, there's, just like USCIS has their policy memos, the SEC has what they call the No Action Letters.

So if you go through some of the case law and these No Action Letters, it becomes quite clear, at least to me, that people who are residing in the U.S. and operating, and doing business to affect the securities' transactions absolutely should be registered.

I don't think there's any gray area. It would be up to the regulators to decide if the migration agents who have offices in the United States if they're violating securities law, but this is again where I think the onus is on the issuer. I think for the person who is raised, the developer or the regional center, or the issuer who wants to raise capital, what I would do is try to be as conservative as possible in my practices.

I think by engaging with a foreign migration agent you may have a Reg S offering in place, meaning the activity occurs offshore. That's probably fine. And as long as it occurs offshore you're probably in a safe harbor. But I think by that migration agent having an office in the United States and having persons who are compensated in some form, I think that that would then again perhaps violate the Reg S exemption.

And we come into the whole point of do you need to do that. I think you can do capital raises without engaging with firms who have U.S. representatives.

Rios: Michael, you have previously expressed concerns about how Chinese immigration brokers seem to be very attracted to EB-5 offerings. Can you tell us what the function of a Chinese immigration broker is and what their role is with respect to potential EB-5 investors?

Gibson: The role of the Chinese migration agent is basically to raise capital. They're the intermediary between the U.S. issuer or developer and the Chinese investor. And I say in this case China, they're the largest market. They account for over 80 percent of the capital raised in the market, but there are agents elsewhere. There are agents in China, Russia, Brazil. They're not as well developed so we'll focus on China.

The migration agents actually started off as issuing just visas. Their primary function as I understand was to issue visas to foreign countries. Primarily they're travel agents. I mean, I think they're licensed as travel agents, so they're not financial experts, and we've seen that recently. They really don't understand the complexity of these transactions.

What has happened is they facilitated the issuance of the visa information from the investor to the immigration attorneys who would then file the I-526.

Now their role has evolved over time into where they are actually now pretty formidable investment banks. They actually get to dictate which U.S. projects get funded and which don't. So their role is primarily what we would look at in the United States as broker/dealer. They are effectively, for all practical purposes, a broker/dealer.

Now they're operating offshore and the way they're operating is slightly different because unlike in the United States where all the fees need to be disclosed to the investors, overseas apparently there is no such requirements.

They're going to the investors, they're telling them these are safe securities, these are the promises. There's discussion of under-the-table redemption guarantees, which are illegal.

The whole point is they are a highly motivated sales force. Some of them have offices in all of the provinces. They may have more than 100 staff. The presentations are second to none. Some of these occupy huge space in the best hotels in China. They have a huge staff of very smart, friendly sales persons, and their goal really is to introduce these projects to the Chinese market, to their clients who are the investors.

Our concern is that there isn't full disclosure of all the material information that they need to know. So we've seen cases in the United States where EB-5 projects are undergoing either litigation, don't have all their permits issued, there is some material obstruction to the project being developed and this information is not being disclosed to the investors. That would be number one.

Number two would be that the fees disclosure, the fees paid to these migration agents are not also disclosed. Now that didn't used to be a problem a few years ago in 2007/2008. The average fee was about 15 to 20, $30,000 and that was taken from the administration fee that is charged up front. Over time, because the projects have grown in size and the need to raise capital has increased both in size and the velocity, these projects are having to get funded in sooner, in shorter and shorter time intervals. What has happened is the agents have started to charge more and more.

So now in a typical arrangement they will charge all of the upfront administration fee, which would range between 40 to $60,000, and in addition they will charge points on the loan or the debt arrangement. The way that would work is that the developer would be charged a fee, let's say eight percent. They investor would be typically given one percent. So there is a seven point spread, some of that would go to the regional center and other parties and then the rest would go to the migration agent.

In some cases we're seeing a compensation package of front-end and back-end fees of over $150,000 per $500,000 investment, which I can guarantee you none of the Chinese investors are aware of.

Rios: Just for discussion purposes, let's say the regional center pays $150,000 to a Chinese immigration broker. That sounds like a lot of money. Could this payment have a negative impact to proposed EB-5 business enterprises, and what happens to the financial feasibility?

Gibson: I don't think they would affect the feasibility of the project. The project itself is really in its own silo, so whatever the asset that's being developed. I think the success is going to be based more on the, on the business plan and the adoption of that asset into the local market.

If it's a hotel, if there's demand for hotel rooms in that market, I think that the project will do very well.

It really depends on the micro, the macro conditions, the need for the asset. If it's a commodity extraction, for instance an oil, natural gas, or gold, or even milk in the ca-, that's another commodity, if there's demand for the asset, for the product, then I think the job creation will occur and the eventual exit should occur with, regardless of any fee commission.

I think where we see the problem, and we actually don't really care what the fees are that are paid to the agents. I mean in some cases the agents work quite hard doing seminars and marketing, and I know they spend a considerable amount of resources to get the investors into these projects. We don't actually have a problem per se with the fee arrangement. Our issue is with the disclosure of that compensation agreement to the client.

I think the reason that is material or important in our view is that by not disclosing that, the clients think, the investors think that the agents are their friends and that they're doing this because they're, they have their well being in mind. We know from the study of ethics and markets going back millennia that when you have such a large compensation in front of a person, they're going to be highly motivated perhaps not to disclose any potential issues to the client.

I think the issue becomes with such a large fee in place – imagine if somebody was paying you $150,000 and you knew of some inherent problems in the program or in the project, or in the asset, or in the market, how motivated would you be to tell this potential client?

I think the problem is without disclosing these fee arrangements the investors are not aware that this significant amount of motivation might dissuade this migration agent from giving them full and complete disclosure on all of the material aspects of the investment.

Rios: We thought one of the main purposes of EB-5 capital was to provide low cost capital to be invested in U.S. businesses. Are these types of payments to Chinese immigration brokers being disclosed by regional centers to their EB-5 investors?

Gibson: I'm going to say the role of the regional center itself has evolved over time. Where we used to see just a few years ago the regional center was the owner/operator/developer/general partner in the development of the asset, nowadays that's not so common. Typically we see the regional center becoming itself a marketing agent if you will.

I think there may be some securities questions as to the role of these regional centers. For instance, very popular in the program right now is the "rent-a-center concept." For developers who do not have a regional center but they want to claim the indirect construction or other jobs from the activity, they may partner with a regional center, and these regional centers are typically charging fees for the amount of capital that they will raise because these developers have no connections offshore. They don't know anybody in China or anywhere else in the world for that matter.

A typical arrangement under this rent-a-center concept would involve people from the regional center going overseas engaging with the migration agents and other finders to source the capital. And in return the U.S. persons who operate the regional center are paid a fee.

And I think again, we can look at that and question whether that is a success-based fee. Do these people need to be registered either as brokers, which I think some would consider that broker activity, or as investment company, or investment companies under the Investment Company Act?

The role of the regional center has I think evolved from where they were owning and operating the asset to now where they're simply marketing or renting out their center, leasing their center. And beyond the securities questions I think again, we come to the issue of the fees. I think if the center were to disclose to the investors that we are paying these migration agents such large fees, the investors might themselves question how honest and open the regional center is about any issues that it may have.

So again, the problem that we're seeing, it's not the size of the commission, it's the lack of transparency regarding who is getting paid.

The reasons why they're getting paid so much, the motivation may dissuade material information from ending up in the hands of the foreign nationals.

***Rios**:* If our understanding is correct, back in 2011 you started questioning the business practices of larger immigration brokers.

***Gibson**:* I don't want to place so much emphasis on the foreign migration agent. They have their role, which is to raise capital. They're paid a fee. Some may argue is it too much, is it too little? I don't think that's really the core question. I think the core question is are these migration agents conveying to their clients all of the material information necessary to make this very important investment decision. I think that's the core question.

My sense is because of the size of the fees they are not. They are not motivated to disclose all of the potential material information that would be required. I think there is the breakdown of the system.

Unfortunately for the U.S. developers, they need these agents, these finders, to be able to raise the capital. Most U.S. developers do not have any external contact, so they have no resources to raise the capital on their own.

We recognize the role of the agent. I think the question is one of transparency in being fair to the investor. In this case what we see is because of the size of the fees we feel that the investors are not getting all of the due care that they should be. And this may ultimately cause problems for the developer, because as we discussed earlier if it was found during the course of events if there is a denial of the I-29 or if there is a failure to return principal back to the investors, I think the investors will be unhappy and they may turn to litigate.

When they litigate it may come out that they were told certain things that were not true, or led to believe some things that may have not been accurate. I think ultimately this will not cause problems for the migration broker. The migration broker is not in the United States. They would not probably be subject to any action.

The problem, the burden of proof as to whether certain marketing or actions were committed is going to fall to the U.S. issuer and probably the regional center. At that point there would be some discovery. I think in the course of events if it turns out that there is a forensic audit and they are finding that these huge fees were paid, the investors may say we did not know that 30 or 40 percent of the fees generated from this investment went to foreign persons and I think that's fairly material. We want our money back.

Again, from our standpoint it's not a necessary issue to avoid. I think by being up front with the investors and saying, yes, we are, we do not have the ability to raise capital in your country. We have hired these third party finders and we are paying them this fee. By disclosing that fact you then eliminate the issues at the end should there be some sort of litigation where the investors say we were never told of this. That could be seen as a material fact not being disclosed. By simply doing that simple letter of disclosure to the investors, that would eliminate a lot of the problems for the issuers down the road.

***Rios**:* Going forward, what would you recommend as a best practices policy payments made by regional centers to immigration brokers?

***Gibson**:* If I had a crystal ball here and looked into the future, what I would see is there is going to be more scrutiny of the industry. There's going to be more scrutiny by regulators, both from USCIS and the SEC, as well as the state regulators. But beyond that, I think there is going to be more scrutiny as more projects fail. This is like any other market, projects are going to succeed and some projects are going to fail.

We're going to have a few more Chicagos that fail, and I think it will then invite more mainstream scrutiny from either the media or perhaps even from Congress. We're not at that stage yet. There is time for the industry to institute some best practices, learn from other segments of the capital markets that do a much better job of disclosing all the material information.

In the private equity world it took years, but now you can see that these safeguards, these investor safeguards are instituted in almost every offering.

We're seeing now with the passage of the Jobs Act an increased interest in other sources of private equity funding through crowd sourcing or crowd funding. And the SEC is very heavily involved in crafting what the investor protections are going to be.

Unfortunately, in our industry for years it has been primarily unregulated. USCIS did not really have much concern for the way the securities were issued or marketed, and the SEC and state regulators were not concerned either. I think with this Chicago action we are now seeing that there is going to be more scrutiny, more what we call in Florida more sunshine on this industry. The issuers have to say well we can't do things the way we used to do a few years ago. We would go to China and just make all these agreements and nobody would know about it, and that was not a problem.

Going forward you're going to have investors who are not going to have a happy outcome. They're going to engage with litigators. They're going to do a process of discovery, and if they find some issues were not disclosed, it could be the fee issue or it could be another issue, if they find that these were not disclosed to the investor, I think it leads to problems for the issuer.

My viewpoint on this is to err on the side of being more conservative, doing more transparency, more disclosure to the clients, because ultimately that puts them in a safe harbor.

***Rios**:* Michael, last question. What could be the legal consequences, particularly from the SEC, to a regional center and their investors that use Chinese immigration brokers who also operated within the U.S. and that did not register as securities broker?

***Gibson**:* Again, the role of the immigration attorney in this industry has also changed. What we used to see a few years ago was that by and large the immigration attorneys would tell, they would have clients walk in their office – and at that point there were only a handful of projects to select from.

So they would use what they had information on and they would say, perhaps this is a short list of projects which we know are in the market. We may or may not give recommendations on the viability of them, but some of these may have what they call a suitable track record, meaning they have 526 and 829 approvals.

That has evolved over time into where the regional centers again, because they are under such intense pressure to raise capital for their developers, they have used this source of funding, if you will, the immigration attorney community network, they have gone to them and said if you send us your clients we will pay you a fee in return.

So this came at the same time in which the recession occurred, 2008/2009, so a lot of immigration attorneys were losing business from their traditional sources, the NIVs, the non-immigrant fund, the Hs, the Es, and Ls, and Os, which had declined with the downturn in the economy. For an immigration attorney it's a very attractive prospect where they can receive a fee as high as $60,000 for simply referring a client to this regional center.

That leads potentially to problems down the road for them should that investment fail. What could happen is then if the project fails the client, the investor would turn in the discovery process and say my immigration attorney not only recommended this project to me acting as an investment advisor, but they also collected a fee for doing so, acting in dual capacity, serving both the issuer and the investor.

I think apart from the ethical, legal, bar issues with dual representation, from a securities standpoint then they could be seen as acting as unregistered investment advisors promoting investments to their clients, and secondly, being compensated. So whether or not some people might argue this is, was a one-off activity and they could be considered perhaps just a finder, I think the problem then arises if they were compensated in the agreement and the project fails, the relief being sought would be not only for the commission that was paid but perhaps for the full investment, plus all of the other issues, if they are facing removal.

Remember in EB-5 there's only four possible outcomes, and three of those are negative for both the investor and perhaps potentially for their attorney. The first one is great. They get their green card and they get their money back. But the other three, either they don't get their green card or they don't get their money back, or a combination of the two would be problematic.

In the case where the attorney received a fee, a finder's fee, very clearly that would establish them in my eyes as an agent of the issuer or the regional center. I think as such they would be treated a lot differently than if they were simply giving legal advice as to the immigration options.

Over the last few years we've seen a substantial number of attorneys who have crossed over, if you will, from giving simple legal advice to now counseling issuers, regional centers, and actually even going offshore to promote projects to foreign nationals and being compensated in the process.

And certainly from a regulatory standpoint one would have to be concerned, because a lot of this activity is going now beyond the framework what they were admitted to the bar to do, which was to give legal advice. Now they are acting more in the role of the capital formation, the capital raising, giving investment advice to their clients and acting as agents or finders for the issuer.

There's a lot more securities issues that they have now become involved with without the protection of the insurance, which would cover them for the legal liability.

For the immigration community there should be concerns. Certainly the SEC stakeholders' conference call was a good source of information so that the immigration attorneys who may not have been aware that by telling my clients this is a good investment and being compensated for it, I am now acting as an investment broker and investment advisor.

Now having heard that conference call with all the different divisions, it should serve as good guidance going down the road how they want to craft their practice to avoid potential future problems should their clients be involved in a project that eventually fails to meet one of the two critical conditions.

***Rios**:* U.S. Advisors is a firm dedicated to helping bring accurate information and analysis of issues related to the EB-5 industry. If you have questions for Michael regarding today's dialogue please visit our membership forum.

We hope you found this dialogue with Michael Gibson useful and we look forward to bringing you more webcasts with information that will help you make educated decisions for your EB-5 venture.

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