INCREASING SEC ENFORCEMENT ACTIONS DRIVE COMMENTS ON

PROPOSED INTEGRITY PROVISIONS BY EB-5 SECURITIES ROUNDTABLE

The Securities and Exchange Commission (“SEC”) this week announced that it brought a record 868 enforcement actions over the past federal government fiscal year (ending September 30, 2016), setting all-time highs for cases exposing financial reporting-related misconduct by companies and their executives and misconduct by registrants and gatekeepers, including investment advisers, investment companies, and attorneys, and securing judgments and orders totaling more than $4 billion in disgorgement and penalties. The agency also reached new highs for Foreign Corrupt Practices Act-related enforcement actions, and for amounts distributed to whistleblowers in a single year ($57 million).

Troublingly, the EB-5 Immigrant Investment Program made up an growing sub-set of this world of increasing SEC enforcement, with a number of civil and criminal enforcement actions now underway for securities fraud (and other alleged violations), and many public (and an undisclosed number of private) settlements having been secured from immigration lawyers for receipt of unlawful broker fees. The enforcement cases in particular, involving as they do large sums of money with a minimum investment of $500,000 per investor, have received considerable attention, in particular the initial action, the Chicago Convention Center case with over $150 million of investor funds at risk, and the very recent Jay Peak/Vermont case with over $200 million of investor funds at risk.

While just a small fraction of the SEC’s overall enforcement activities over the past year, the EB-5 cases are higher profile, not only because of offering dollar amount, but also because the Regional Center “sub-program” under the broader EB-5 Program requires reauthorization to continue, and the wild 2016 election year coincides with the Regional Center Program’s scheduled sunset absent affirmative Congressional action to renew it. Congressional concern with fraudulent abuse of the regional center aspect of the broader EB-5 Program has driven both the Senate and House to generate draft integrity measures to be adopted as a precursor to any substantive enhancement of the EB-5 Program, let alone its extension.

In the Senate, Judiciary Committee chairman and ranking member Senators Grassley and Leahy published a letter on September 8, 2016 opposing a “straight” (no changes) reauthorization of the EB-5 Regional Center Program without the prior adoption of significant integrity measures along the lines of their proposed bill S. 1501. That bill was heavily negotiated between the Senate and EB-5 industry stakeholders back in November and December 2015 and seemed near adoption in mid-December before time ran out and the bill was shelved. The very next day, September 9, 2016, Representatives Goodlatte and Conyers, chair and ranking member of the House Judiciary Committee, released a draft EB-5 Program reform bill, H.R. 5992, addressing some of the “minimum” reforms referenced in the Grassley-Leahy letter, and built on last year’s S. 1501, though with some significant changes.

Like S. 1501 (and additional integrity bills proposed in both houses of Congress earlier in 2016), the focus of the bill’s integrity provisions is on imposing oversight obligations on EB-5 regional centers. Offerors and issuers of EB-5 investments are already regulated by the federal (and state) securities laws. However, under the EB-5 Program, regional centers historically have had minimal practical responsibilities, basically just securing a small amount of lump-sum information to be contained in a single annual filing. All of Congress’ draft legislation (1501, the Senate EB-5 Integrity Bill, the House EB-5 Integrity Bill, and now 5992) seek to change that by imposing affirmative integrity measures on EB-5 regional centers.

H.R. 5992’s regional center integrity measures are contained in the oversight provisions of Section 3, entitled “Reauthorization and Reform of the Regional Center Program,” most of which closely track the oversight provisions of S. 1501. Included are the same sort of extensive initial and annual reporting requirements, securities law compliance certifications, background checks, project preapprovals, site visits, investor fraud protections, and sanctions. Newly added to Section 3 is language addressing account transparency, requiring a more active role for banks handling EB-5 escrows. Repeated are 1501’s “Integrity Fund” provisions and amounts. Effectiveness of these provisions is set for no later than 90 days after enactment, though many provisions appear to require regulations or other detailed guidance.

Section 2 of 5992 addresses revocations, denials, and debarments for national security threats and fraud, as well as investor source of funds restrictions. Section 4’s provisions increase the minimum investment from $500,000 and $1 million, to $800,000 and $1.2 million respectively, add non-rolling visa set-asides, significantly change the rules for determining targeted employment areas (“TEAs”), include a minimum direct job requirement, allow for retroactive application (“grandfathering”) back to June 1, 2015, and have varying effectiveness dates. Section 6 imposes a minimum age requirement of 18.

In response, various stakeholders within the EB-5 industry have provided feedback and input addressing different provisions of the draft legislation. Chief among those addressing the integrity provisions is the EB-5 Securities Roundtable, an informal, independent group of securities attorneys (including the authors of this article) who regularly represent regional centers, issuers of EB-5 securities, and borrowers of EB-5 funds. A primary goal of the group is to inform lawmakers that the proposed integrity provisions must correlate with the existing securities laws. The Securities Roundtable has provided written comments to the House on H.R. 5992 (and also to the Senate on S. 1501) representing the consensus views of the individual participants (though not necessarily the views of any individual, law firm, or client). Taken cumulatively, those comments seek to facilitate the integrity provisions’ anti-fraud effectiveness by helping them (quoting from the group’s early August, 2016 press release):

* Further the goals of improving integrity and accountability in the EB-5 regional center program
* Accurately reflect the roles of various participants in an EB-5 securities offering
* Conform to recognized principles of U.S. securities laws and regulations
* Enable the proposed integrity provisions to work harmoniously for their intended purposes throughout the typical EB-5 offering process
* Define various terms used in the legislation to be consistent with U.S. securities laws and regulations, USCIS regulations, and common EB-5 industry practice
* Enable compliance by regional centers by clarifying their obligations in connection with EB-5 offerings they sponsor
* Where appropriate, import proven securities regulatory mechanisms to achieve the intended purposes of the integrity provisions.

Since the integrity provisions of H.R. 5992 dealing with securities law compliance and anti-fraud enhancement in EB-5 are within the professional practice focus of securities lawyers, the Securities Roundtable’s comments focus exclusively on those provisions, and intentionally do not address the other immigration policy and eligibility aspects of the proposed legislation, such as minimum investment, TEA definition, visa availability, effective dates, and the like.

Going beyond providing comments on the provisions of the draft legislation, the Roundtable has proposed additional integrity enhancements to reduce the potential for fraud in future EB-5 offerings, including:

* Independent due diligence review of project information included in EB-5 offering documents, in particular where the EB-5 issuer is under common control with the project owner, to confirm the accuracy of the information and reasonableness of the projections used to demonstrate estimated job creation;
* Independent fund administration of EB-5 investment proceeds to hold and disburse EB-5 investment funds to avoid investment of funds in businesses other than that described or misappropriating funds for personal benefit, especially now that many EB-5 offering sponsors only retain investment funds in escrow for a short period of time; an independent fund administrator would hold funds until disbursement to the project developer, and release funds only upon satisfaction of conditions on disbursement, similar to the draw down procedures in bank construction loan projects; and
* Independent review of financial statements of project funding recipients and a requirement for the issuance of quarterly and annual financial statements that are reviewed or audited by independent public accountants to assure deployment of EB-5 funds into the promised business and timely and correct distribution of proceeds.

As for the initial and annual certification obligations imposed on regional centers by H.R. 5992 (and other EB-5 focused integrity bills, including S. 1501) to assure that every EB-5 offering they sponsor has the appropriate procedures in place to verify project information included in EB-5 offering documents, to assure proper fund administration and disbursement, and to review and verify the proper use of EB-5 funds by issuers and businesses, the Roundtable proposes that the draft legislation give regional centers the option to (1) perform some or all of these responsibilities themselves, if independent of the issuer and project and have the necessary qualified personnel, (2) engage qualified and experienced third parties to perform these tasks, or (3) rely on qualified and experienced third parties engaged by the issuer and/or project developer to satisfy these requirements. The Securities Roundtable has also proposed that regional centers be responsible further for confirming that the third parties engaged to provide due diligence, fund administration, and financial statement review are performing their functions, by obtaining copies of their reports along with certifications.

Taken together, the Roundtable’s comments to the proposed EB-5 legislation plus the additional suggested measures beyond that legislation offer the prospect of achieving the goals of improving on the legislation to avoid unintended consequences, harmonize the legislation’s requirements with existing securities laws, eliminate ambiguities in wording, and impose on regional centers responsibilities that can be accomplished without costing excessive time or fees. Hopefully the Congress will receive these comments in the collaborative spirit in which they were generated and delivered.