

Client Alert

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SEC Brings First Charges Against Unregistered Broker in EB-5 Immigrant Visa Program

On June 23, 2015, the Securities and Exchange Commission (SEC) brought its first enforcement action against an unregistered broker-dealer handling investments in the federal government's EB-5 Immigrant Visa Program. The case signals the SEC's continued interest in policing the EB-5 space for violations of the federal securities laws. It also serves as a cautionary tale to intermediaries who seek to match investors with investments.

The EB-5 program, which is administered by the US Citizenship and Immigration Services (USCIS), provides a path to legal residency for foreign citizens whose investment of at least \$500,000 in a US business results in the creation of 10 or more full-time jobs for US workers. The required job creation may result directly from the investment, or indirectly via an affiliation with an approved "regional center" that promotes economic development in specific areas and industries. Although the EB-5 program has been in place since the 1990s, it has become increasingly popular in recent years.

According to the SEC's order,¹ the two defendants used a website to solicit EB-5 investors, some of whom were already in the United States on a temporary visa. While the defendants promised to help investors choose the right regional center to invest with, they appeared to direct most EB-5 investors to the same handful of regional centers that paid them average commissions of \$35,000 per investor once USCIS approved an investor's petition for conditional residence (also known as a "green card"). The two defendants were charged with acting as unregistered brokers for more than 150 EB-5 investors.

The federal securities laws contemplate a very expansive notion of what it means to be a securities broker or dealer. Section 3(a)(4) of the Securities Exchange Act of 1934 defines a "broker" as "any person engaged in the business of effecting transactions in securities for the account of others." Similarly, Section 3(a)(5) defines "dealer" as "any person engaged in the business of buying and selling securities...for such person's own account through a broker or otherwise." A person engaged in a broker-dealer business under the federal securities laws must register with the SEC. Registration as a broker-dealer subjects a registrant to numerous compliance requirements under the Exchange Act, as well as the obligation to be a member of a self-regulatory organization.

The terms "effecting transactions" and "engaged in the business" are not defined by statute or in any SEC rules. Nonetheless, the SEC and the courts have interpreted "engaged in the business" as requiring a certain regularity of participation in the securities markets. Two factors are important in determining whether regularity of participation exists: (1) the number of transactions and clients, and (2) the dollar amount of securities sold. Another indicia of being "engaged in the business" is holding oneself out as a broker, executing trades or assisting others in settling securities transactions.

According to various interpretations issued by the SEC staff, "effecting transactions in securities" may include, among other activities:

¹ The full text of the SEC order is available here: <http://www.sec.gov/litigation/admin/2015/34-75268.pdf>.

- structuring securities offerings;
- helping an issuer identify potential purchasers of securities;
- screening potential participants in a transaction for creditworthiness;
- soliciting or advertising securities transactions;
- negotiating between the issuer and investors;
- assessing merits of an offering or giving advice on whether to invest;
- taking, routing or matching orders, or facilitating the execution of a securities transaction;
- handling customer funds and securities;
- preparing and sending transaction confirmations; and
- accepting transaction-based compensation (such as sales commissions) based on the size, value or completion of a securities transaction.

Although the SEC's order does not provide a detailed legal analysis of how the defendants violated the broker-dealer registration rules, the order's factual summary describes various activities undertaken by the defendants that the SEC has historically interpreted as engaging in the business of effecting transactions in securities. For example, after identifying foreign investors, the defendants offered to assist those investors in choosing EB-5 projects. To that end, the defendants spoke to prospective investors about their background, visa status, understanding of how US businesses operate, area of business in their home country and interest in a particular geographical area or a specific type of EB-5 project. Once the defendants had a better understanding of the potential investor's EB-5 preferences and suitability, the defendants gave investors one or more EB-5 regional center projects as possible choices, as well as background information about those centers. The defendants then performed due diligence on each of the regional centers it selected for the investors.

After investors identified which of the regional centers they were most interested in, the defendants "registered" the customers with the regional center by providing their names, contact information and visa status. Investors periodically contacted the defendants if they had questions about the investments or offering materials. Under "referral partner agreements" among the defendants and the regional centers, the centers compensated the defendants for each registered investor who invested funds in an EB-5 offering. The defendants earned the fee once the USCIS approved an investor's I-526 petition (also known as a conditional green card). The fee was a commission based on a fixed portion of the "administrative fee" the investor paid to the regional center. The SEC has frequently warned that the receipt of a sales commission in connection with a securities transaction creates a "salesman's stake" that provides a strong indication a broker-dealer relationship exists.

While engaging in some of the foregoing activities on a one-off basis should not give rise to an inference that a person is conducting a securities business, it is likely that the SEC considered the totality of the circumstances, the frequency and regularity of the transactions, and the receipt of transaction-based compensation in the form of sales commissions in determining that the defendants violated the broker-dealer registration provisions. To settle the case, the two defendants agreed to be censured and to cease and desist from committing or causing similar violations of the federal securities laws in the future. They also agreed to administrative proceedings to determine whether they should be ordered to return any ill-gotten gains, pay penalties or both based on their violations.

The consequences of failing to register as a broker-dealer when required, or using the services of an unregistered broker-dealer, can be serious. They include: (1) a potential right of rescission on the part of investors under state or federal law; (2) potential fines, disgorgement and injunctions; (3) potential reputational risks in the marketplace and negative publicity; (4) potentially losing the ability to rely on the Regulation D safe harbor exemption for issuing securities or participating in securities offerings that are not registered with the SEC; and (5) being barred from the securities industry. In extreme circumstances, criminal liability may also attach. Accordingly, this case should serve as a warning not only to unregistered intermediaries engaging in practices similar to those of the defendants, but also to other participants in EB-5 transactions, about the risks of doing business with an unregistered broker-dealer.

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