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## **“EB-5 2.0: Can Account Transparency Save the Program?”**

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**Text of Account Transparency Requirement extracted from H.R. 5992 appears immediately after the Conclusion page**

## “EB-5 2.0 – Can Account Transparency Save the Program?” **DRAFT**

### Introduction

Responding to mounting reports of securities and investor fraud involving the EB-5 Immigrant Investor Program (the “Program”), several bills that attempt to improve the integrity of the Program have been introduced in Congress in recent years. An EB-5 reform bill would not represent true reform unless it sought to deter the misappropriation of investor funds that was at the core of several recent SEC enforcement actions.<sup>1</sup> Adding the “Account Transparency Requirement” to H.R. 5992, the most recent Congressional attempt to reform the EB-5 Program, demonstrates a commitment to truly restore integrity to the Program.<sup>2</sup> As explained in this article, the Account Transparency Requirement may be the most important of the integrity and investor protections advanced by the bill.<sup>3</sup>

The provision would impose new controls on the flow of EB-5 investor funds. Account Transparency addresses actual fund administration, the area where the recent abuses have surfaced. It aims to (1) deter principals of new commercial enterprises and related entities from misappropriating EB-5 investor funds; (2) promote early detection by USCIS, investors and third-party inspectors of any unlawful diversion; and (3) enhance government enforcement, discovery and recovery of the misappropriated funds.

The media’s reporting of the fraud perpetrated in the EB-5 arena has recently focused on Jay Peak in Vermont. However, Jay Peak is merely one of the many misappropriation cases. Within the past two years, the Securities and Exchange Commission (“SEC”) has filed EB-5 enforcement actions throughout the country. The projects have been located on the West Coast (from southern California to Washington), on the East Coast (from south Florida to Vermont), as well as in the nation’s midsection (Texas and Illinois).<sup>4</sup>

This article will explain each of the requirements imposed by the Account Transparency Requirement, the purpose to be served by each requirement, and the type of abuses the specific

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<sup>1</sup> These cases involve a series of SEC enforcement actions brought against EB-5 entities and their principals alleging misappropriation of EB-5 investors’ funds. See Note 17 *infra* for a list of these cases.

<sup>2</sup> On September 12, 2016, House Judiciary Committee Chairman Bob Goodlatte (R-VA) and Ranking Member John Conyers (D-MI) introduced H.R. 5992, titled the “American Job Creation and Investment Promotion Reform Act”, <https://www.congress.gov/bill/114th-congress/house-bill/5992/text>. The Account Transparency Requirements are set forth in Subparagraph (P) to be added to 203(b)(5) of the INA. The text can be found at pages 64 through 72 of H.R. 5992. For the reader’s convenience, a copy of the section’s text is reprinted at the end of this article. H.R. 5992 is a companion to the Senate bill of the same name, introduced as S. 1501 in June 2015 by Senate Judiciary Chairman Chuck Grassley (R-IA) and Ranking Member Patrick Leahy (D-VT).

<sup>3</sup> Senator Leahy’s press release supporting H.R. 5992 stresses: “Importantly, the House proposal includes additional reforms that I suggested to require transparency and promote accountability in the use of investor funds. It ensures that investors and the Department of Homeland Security can better track investments and requires a third party to sign off on any expenditures.” <https://www.leahy.senate.gov/press/senator-leahy-welcomes-bipartisan-house-bill-to-reform-foreign-investment-program-eb-5>.

<sup>4</sup> The Illinois case, the Chicago Convention Center, was the first SEC enforcement action in the EB-5 arena. *Infra* at Note 17. Technically, it did not involve a diversion of funds. It involved massive fraud. The operator was apprehended before he had an opportunity to misappropriate the investor’s funds. The misappropriation cases are: Ramirez, Path America, Zhong, Suncor, Jay Peak and Proton. See also Luca. *Infra* at Note 17.

requirement aims to remedy.<sup>5</sup> We present the explanation in a question and answer format because we believe this is the most effective way to convey these technical rules. We discuss why these rules are not a substitute for due diligence by the investor. We also explain the stop-gap measures that we recommend USCIS should implement, in the event that legislative reform continues to be delayed.

Before we explain the requirements, we will provide background as to the events and circumstances prompting the need for these type of integrity protections.

## Background

### Efforts of SEC and USCIS to increase transparency

The lack of transparency that permeates the Program makes it extremely difficult to ascertain the level of fraud that actually exists. Several factors contribute to the opaqueness: minimal disclosure required by the EB-5 law; lax enforcement by USCIS until recently; the secrecy surrounding the substantial financial savings to developers and lucrative fees earned by regional centers and migration agents; the unwillingness of many members of industry to self-police; the absence of government mandated internal controls; and the lack of a watchdog.

Transparency and full disclosure are the foundations of the Federal securities laws.<sup>6</sup> From the Program's inception in 1990 until circa 2009, the industry did not even recognize that the immigrant's investment constituted a security for purposes of Federal securities law.<sup>7</sup> The SEC did not focus on the Program until the use of EB-5 capital became a mainstream capital source after the financial crisis. The first SEC enforcement action was not filed until 2013, over 20 years after the program was first established.<sup>8</sup>

From January 2013 to January 2015, the SEC received over 100 tips, complaints and referrals relating to possible securities fraud violations in the EB-5 Program.<sup>9</sup> As of May 2015, the SEC and other law enforcement agencies had 35 open investigations primarily involving securities fraud in the EB-5 context.<sup>10</sup> This data does not reflect the SEC's stepped-up enforcement activity, as evidenced by the series of misappropriation actions filed since the summer of 2015 described below. As further evidence of the importance the SEC places on eliminating fraud in the EB-5 space, for the first time, in 2016, the SEC's Office of Compliance and Examination listed the Program as one of its annual examination priorities.<sup>11</sup>

Similarly, until recently, USCIS played a relatively passive role in monitoring for and investigating EB-5 fraud. Wisely, in November 2013, USCIS established a fraud specialist unit

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<sup>5</sup> This article will limit its discussion of the misappropriation cases to the extent relevant to the particular requirement. A more in-depth analysis of these cases will be included in the soon to be released NYU Stern CREFR database of securities law cases and administrative actions in the EB-5 area.

<sup>6</sup> Securities Act of 1933; Securities Exchange Act of 1934; Also see <https://www.sec.gov/about/whatwedo.shtml>

<sup>7</sup> [http://www.seyfarth.com/dir\\_docs/news\\_item/e0297d1d-5585-4935-adb3-a677cdcfdeb2\\_documentupload.pdf](http://www.seyfarth.com/dir_docs/news_item/e0297d1d-5585-4935-adb3-a677cdcfdeb2_documentupload.pdf)

<sup>8</sup> See also, [https://www.sec.gov/investor/alerts/ia\\_immigrant.htm](https://www.sec.gov/investor/alerts/ia_immigrant.htm)

<sup>9</sup> Government Accountability Office. *Immigrant Investor Program: Additional Actions Needed to Better Assess Fraud Risks and Report Economic Benefits* (August 2015). ("GAO Report") at page 19. Available at: <http://www.gao.gov/assets/680/671940.pdf>.

<sup>10</sup> GAO Report at page 20. Supra at Note 9.

<sup>11</sup> <https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2016.pdf>

for EB-5 within its Fraud Detection and National Security Directorate (FDNS).<sup>12</sup> As of August 2015, FDNS's site visits were limited in number and scope.<sup>13</sup> However, during the July 28, 2016, Stakeholder Engagement, Mr. Nicholas Colucci, Chief of the USCIS's Immigrant Investor Program Office, announced that USCIS intends to conduct more frequent site visits and field audits, broader in scope to presumably assist in fraud detection.<sup>14</sup> The heightened sensitivity of the USCIS and SEC to EB-5 fraud and the priority placed on investigations is likely to uncover a significant number of new abuses, especially compared to the fraud uncovered in prior years as a result of tips and whistleblower activity rather than aggressive, proactive government investigations.

Furthermore, USCIS does not scrutinize the investor's actual flow of funds until the final stage of the EB-5 visa process, after the I-829 petition is filed. With the coming "I-829 bubble," and the required USCIS scrutiny of the fund flow,<sup>15</sup> it will not be surprising if more abuses are uncovered. Thus, this also may contribute to the stream of future actions that may be on the horizon.

The two champions in the Senate for EB-5 reform, Judiciary Committee Chairman Chuck Grassley and Ranking Member Patrick Leahy, recently spoke in tandem on the Senate floor insisting that the Program is too flawed to continue without reforms. Their proposed integrity reforms, including the Account Transparency Requirement, would directly address the "rampant fraud" in the Program, cited in the remarks.<sup>16</sup>

## Misappropriation cases

Contrary to the assertion by some that EB-5 fraud is limited to a handful of regional centers, the scope of the fraud is wider. The question is how much wider. The fraud uncovered to date spans all parts of the nation. As indicated in the Introduction to this article, the misappropriation cases relate to projects located throughout the country.<sup>17</sup>

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<sup>12</sup> <https://www.dhs.gov/publication/dhsuscispia-013a-%E2%80%9393-fraud-detection-and-national-security-directorate>

<sup>13</sup> GAO Report at page 27. Supra at Note 9.

<sup>14</sup> [https://www.uscis.gov/sites/default/files/USCIS/Outreach/Notes%20from%20Previous%20Engagements/PED\\_EB5NatStakeholderEng072816\\_ColucciRemarks.pdf](https://www.uscis.gov/sites/default/files/USCIS/Outreach/Notes%20from%20Previous%20Engagements/PED_EB5NatStakeholderEng072816_ColucciRemarks.pdf);

<sup>15</sup> The explosion of EB-5 popularity over the past 4 years has resulted in a surge of I-526 petitions, slower USCIS processing times and longer visa waiting lines which contributes to the longer timeline for petitions to reach the I-829 stage. Consequently, many petitions are expected to reach the I-829 stage over the next year or two. It is not until this stage in the visa process that USCIS carefully scrutinizes the project's actual flow of funds. See <http://www.klaskolaw.com/eb-5-investor-visas/preparing-for-the-i-829-before-its-too-late/>

<sup>16</sup> <https://www.leahy.senate.gov/press/-leahys-speech-just-now-on-the-senate-floor-time-has-come-to-reform-eb-5-or-to-end-it>; <http://www.grassley.senate.gov/news/news-releases/grassley-eb-5-program-too-flawed-continue-without-reforms>. <http://www.grassley.senate.gov/news/news-releases/grassley-leahy-senate-leadership-reform-investor-visa-program-now-or-let-it>. Also see [http://www.nytimes.com/2016/09/12/us/politics/visa-program-up-for-renewal-amid-allegations-of-fraud.html?smid=nytcore-ipad-share&smprod=nytcore-ipad&\\_r=0](http://www.nytimes.com/2016/09/12/us/politics/visa-program-up-for-renewal-amid-allegations-of-fraud.html?smid=nytcore-ipad-share&smprod=nytcore-ipad&_r=0)

<sup>17</sup> For the ease of the reader, we provide a link to the relevant SEC Release announcing the filing of the SEC enforcement action, rather than the case citation.

Chicago Convention Center: <https://www.sec.gov/litigation/litreleases/2013/lr22615.htm>;

Ramirez: <https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539854731>;

Path America: <https://www.sec.gov/news/pressrelease/2015-173.html>

Zhong: <http://www.sec.gov/news/pressrelease/2015-263.html>;

Suncor: <https://www.sec.gov/litigation/litreleases/2015/lr23414.htm>;

Jay Peak: <https://www.sec.gov/news/pressrelease/2016-69.html>;

In the first SEC enforcement action in the EB-5 arena, the Chicago Convention Center, the investors were relatively fortunate because their funds were still held in a subscription escrow account when a whistleblower tipped off the SEC.<sup>18</sup> The fraudulent operator was apprehended before he had the opportunity to divert the funds.

Texas was the location of the first EB-5 project for which the SEC filed an action alleging investor fund misappropriation. In that case, Ramirez, the funds were raised before the regional center designation was approved by USCIS, and the funds were never deposited in escrow as promised.

Starting in the summer of 2015, the SEC commenced a series of enforcement actions alleging misappropriation of the capital investment of EB-5 investors in a new commercial enterprise (NCE), the most notable of which was the Path America case.<sup>19</sup> In April 2016, the SEC brought an enforcement action against Jay Peak that attracted national attention to the problems plaguing the EB-5 program.<sup>20</sup>

All of the misappropriation cases involve the diversion of funds for personal purposes. Some involve the commingling of funds, and/or Ponzi schemes.<sup>21</sup> In Zhong, the regional center owner-operator's fraud also had a devastating impact on the local municipality.<sup>22</sup>

### **Flow of funds and illustrations**

It is elementary that the EB-5 investors' pooled capital should not be commingled with funds from any other source. According to the typical EB-5 business plan, the flow of funds should follow this simple and direct route: first, from the investor to the subscription escrow for that particular capital investment project; next, upon satisfaction of the escrow condition, released to the NCE; and finally, deployed into the project by transfer from the NCE to the job-creating entity ("JCE").

Instead, a common thread runs through the misappropriation cases. Soon after release from escrow, the investors' funds were diverted by the NCE's principals to prohibited destinations, such as to the personal accounts of the principals, to shell companies controlled by them, to accounts commingled with other funds unrelated to the investment, to migration agents overseas, or to investments not contemplated by the project's offering plan or business plan. In some cases, funds were retained by the regional center operator, never reaching the escrow.<sup>23</sup> In other cases, improper escrow structure and lack of third party oversight allowed funds to be released much earlier than set forth in the offering documents.<sup>24</sup> In still other cases, funds were diverted or misused soon after being released.<sup>25</sup> Despite these diversions, in many cases, the abuse did not come to light

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Proton: <https://www.sec.gov/news/pressrelease/2016-105.html>.

See also Luca: <https://www.sec.gov/news/pressrelease/2015-141.html>

<sup>18</sup> Chicago Convention Center. Supra at Note 17.

<sup>19</sup> Path America; Zhong; and Suncor. See also Luca. Supra at Note 17.

<sup>20</sup> <http://www.nytimes.com/2016/05/11/us/fraud-charges-mar-a-plan-to-aid-a-struggling-vermont-region.html>

<sup>21</sup> Ramirez; Path America; Zhong; and Jay Peak. Supra at Note 17.

<sup>22</sup> <http://archive.tcpalm.com/news/shaping-our-future/growth/port-st-lucies-city-center-developer-lily-zhong-must-pay-142-million-to-keep-land-23cf07dd-a149-0ef7-342052981.html>

<sup>23</sup> Ramirez; See also Zhong. Supra at Note 17.

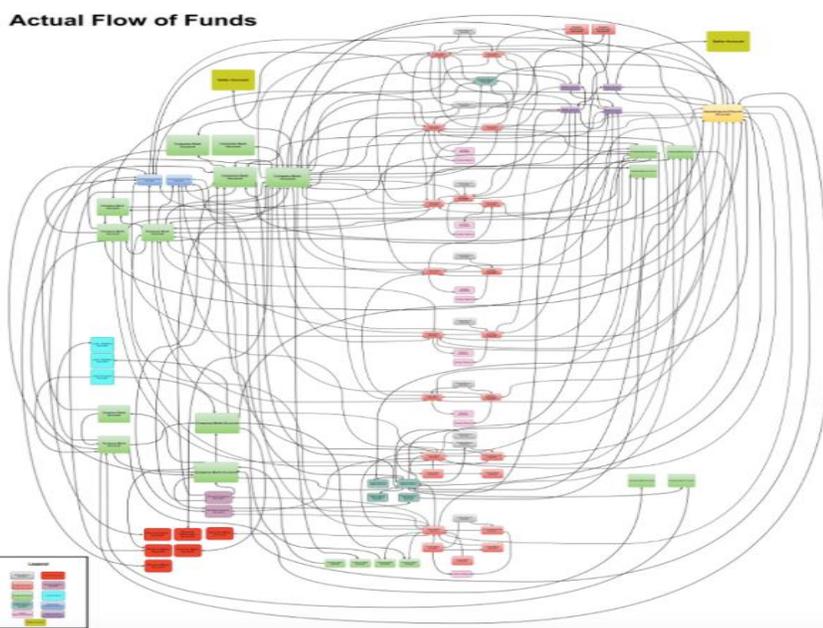
<sup>24</sup> See, Zhong. Supra at Note 17.

<sup>25</sup> See Suncor; Zhong; and Jay Peak. Supra at Note 17.

until many years later, making it extremely difficult to trace and locate the funds, thereby frustrating the ability to recover the funds.<sup>26</sup>

The transfer of funds in the Jay Peak case represents just one example of elaborate and complex web of transfers that unscrupulous NCEs devise to divert EB-5 funds. The Ponzi scheme in Jay Peak involved several projects sponsored by the same developers.<sup>27</sup> The case also illustrates the instrumental role played by the state's regulator in assisting the SEC to detect and then prove the misappropriation of investor funds. Vermont's top financial regulator at the time, Commissioner Susan Donegan, explained that instead of a clean line between investor money and project costs, "the finances were a 'spaghetti map' that saw money being transferred inexplicably between more than 100 accounts at 10 financial institutions."<sup>28</sup>

Below is the "spaghetti map" created by Vermont financial regulators and presented by the SEC in court to illustrate how the EB-5 investors' funds were allegedly misused. This map shows the intricate series of the actual flow of funds among the various "Jay Peak" projects.



*Courtesy of Vermont Department of Financial Regulation<sup>29</sup>*

<sup>26</sup> Zhong; and Jay Peak. Supra at Note 17.

<sup>27</sup> <http://www.dfr.vermont.gov/sites/default/ext/sl/dev/docs/PROJECT%20LIST.pdf>

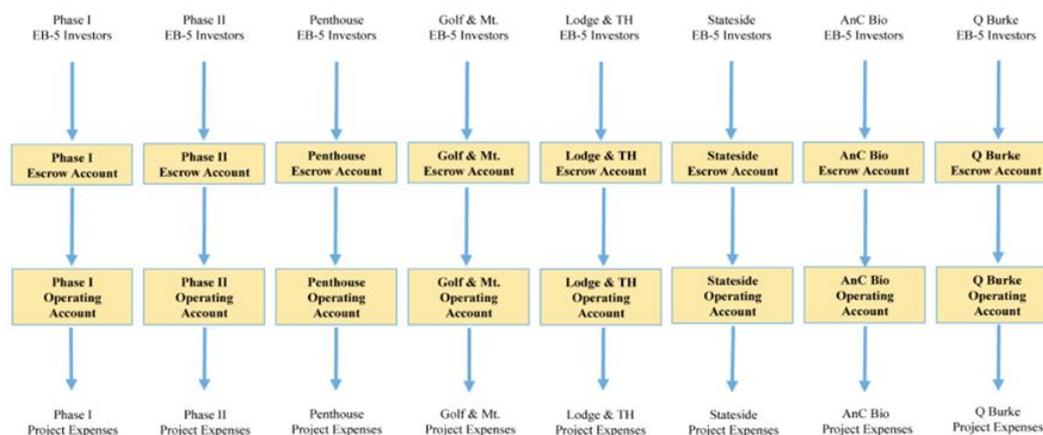
<sup>28</sup> <http://digital.vpr.net/post/commissioner-donegan-discusses-q-burke-allegations-and-investigation#stream/0> The SEC reached the same conclusion as the Vermont regulator. Mark Dee, an SEC accountant and a retired law enforcement officer who specialized in financial services investigations, was responsible for tracing funds and developing a cash flow analysis of the Jay Peak related entities. Dee testified that he examined more than 1,000 transactions and found that all \$350 million in immigrant investor funds were commingled. He described the investigation as the most difficult of his career "because of the commingling between the seven phases and following each transaction of interest. . . It was run through several bank accounts and then run through margin loans." Dee described the convoluted scheme: "They used People's Bank, Raymond James investor accounts, Quiros' accounts — Q Resorts and Jay Construction Management — Treasury bills and margin loans. The flow of funds was circular, and shortfalls for each project were made up by new money from new investors."

[http://www.reformer.com/latestnews/ci\\_29889121/sec-says-its-time-remedy-wrongs-at-jay](http://www.reformer.com/latestnews/ci_29889121/sec-says-its-time-remedy-wrongs-at-jay)

<sup>29</sup> A larger, easy-to-read version of this spaghetti map with zoom-in capabilities and a color-coded legend inset can be found at <http://www.dfr.vermont.gov/sites/default/ext/sl/dev/full-page-funds-map.html>

In contrast to the spaghetti map showing the actual flow of funds, below is a chart that shows the simple and direct anticipated flow of funds based on the offering materials provided to the EB-5 investors.<sup>30</sup>

**Anticipated Flow of Jay Peak EB-5 Investor Funds**



### Integrity provisions in reform bills

None of the reform bills previously introduced in 2015 or 2016, including even the introduced version of S. 1501 (the companion bill to H.R. 5992),<sup>31</sup> imposed any specific controls on the flow of investor funds that would curb the diversion or commingling of these funds. Understandably, S. 1501, introduced on June 3, 2015, may not have considered inclusion of such a control because the Ramirez case, the only SEC action alleging misappropriation filed as of such date, was overshadowed by the massive fraud perpetrated in the Chicago Convention Center case. However, control of the flow of funds was conspicuously absent from the EB-5 Integrity reform bills introduced in the Senate and House after the straight extension of the Program in December 2015, S. 2415 and H.R. 4530, respectively (collectively the “Integrity” bill). Despite the numerous enforcement actions that were brought before the Integrity bills were introduced, the bills even watered down some of the investor protections, rather than strengthened them, as explained below.<sup>32</sup> Apparently, the filing of the action against Jay Peak and the subsequent action in Proton, were the final straws prompting inclusion of the Account Transparency Requirement in H.R. 5992, introduced by House Judiciary Chairman Bob Goodlatte and Ranking Member John Conyers. Both

<sup>30</sup> <http://www.dfr.vermont.gov/sites/default/ext/sl/dev/img/Anticipated%20Flow%20of%20Jay%20Peak%20EB-5%20Investor%20Funds.png>

<sup>31</sup> S. 1501: <https://www.congress.gov/bill/114th-congress/senate-bill/1501>; H.R. 616: <https://www.congress.gov/bill/114th-congress/house-bill/616>; H.R. 3370: <https://www.congress.gov/bill/114th-congress/house-bill/3370>; S. 2122 <https://www.congress.gov/bill/114th-congress/senate-bill/2122?q=%7b%22search%22%3A%5b%22%22s2122%22%22%5d%7d&resultIndex=1>; S. 2415: <https://www.congress.gov/bill/114th-congress/senate-bill/2415>; H.R. 4530: <https://www.congress.gov/bill/114th-congress/house-bill/4530/text>.

<sup>32</sup> Path America; Zhong; and Suncor. Supra at Note 17. The Integrity bill also did not address the controversial economic issues relating to TEA reform.

Senators Grassley<sup>33</sup> and Leahy expressed support for H.R. 5992 when it was introduced, and Senator Leahy specifically pointed to the importance of the Account Transparency Requirement.<sup>34</sup>

Although there is a consensus on Capitol Hill that an EB-5 fraud problem exists and that it “must be fixed,”<sup>35</sup> there is not yet consensus on the approach. Much of the discussion has revolved around the “Integrity bill” and the integrity provisions contained in H.R. 5992 (and the companion S.1501).<sup>36</sup> Two major differences exist. First, the Integrity bill lacks any provisions remotely resembling the Account Transparency Requirement. The Account Transparency Requirement, as described in this article, aims to address the most dominant type of fraud plaguing the Program. Second, the Integrity bill seeks to limit key oversight and transparency provisions to only those entities where the JCE or NCE is under the “common control” with the regional center, and thus the bill exempts all other JCEs and NCEs. Certainly, such common control presents a great opportunity for fraud. However, this narrow application would present the opportunity for many EB-5 entities to create multiple tiers of entities that do not technically fall within the definition.

### Vulnerability of EB-5 investors

EB-5 immigrant investors may be the most vulnerable of any class of investors to fraud schemes.<sup>37</sup> They are unsophisticated in matters of U.S. real estate and business. Most live overseas, a great distance from the project. The SEC points out that the immigrant investor is primarily focused on obtaining a visa, unlike a conventional investor whose sole focus is maximizing a safe, financial return.<sup>38</sup>

The common investment structure where the NCE-lender and JCE-borrower entities are related, such as in an in-house regional center structure, accentuates the investor’s vulnerability. Unlike other real estate development investments outside of the EB-5 arena, it is common for the EB-5 developer to serve the dual role of lender and borrower<sup>39</sup>: lending to itself; negotiating with itself to set terms; and determining whether and how to enforce the loan in the case of a default. Although some of these structures utilize an independent fund administrator, many do not.<sup>40</sup>

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<sup>33</sup> <http://www.grassley.senate.gov/news/news-releases/grassley-statement-house-bill-reform-eb-5-immigrant-investor-visa-program>

<sup>34</sup> See Statement of Senator Patrick Leahy (D-Vt.), “On the Need to Reform the EB-5 Program,” Sept. 12, 2016, available at <https://www.leahy.senate.gov/press/senator-leahy-welcomes-bipartisan-house-bill-to-reform-foreign-investment-program-eb-5> (“Importantly, the House proposal includes additional reforms that I suggested to require transparency and promote accountability in the use of investor funds. It ensures that investors and the Department of Homeland Security can better track investments and requires a third party to sign off on any expenditures.”).

<sup>35</sup> See “The Failures and Future of the EB-5 Regional Center Program: Can it be Fixed?” Senate Judiciary Committee Hearing held on February 2, 2016; <https://www.leahy.senate.gov/press/-leahys-speech-just-now-on-the-senate-floor-time-has-come-to-reform-eb-5-or-to-end-it>

<sup>36</sup> The most noteworthy difference between the two bills is that the Integrity bill does not contain Targeted Employment Area (“TEA”) reforms, whereas H.R. 5992 squarely addresses TEA issues (single census tract, retroactivity, raises minimum investment thresholds for urban and non-urban).

<sup>37</sup> See GAO Report at pages 19 to 21. Supra at Note 9.

<sup>38</sup> GAO Report at page 20. Supra at Note 9.

<sup>39</sup> Technically, substantially all of the equity interests in the NCE are owned by the immigrant investors, but managed by the developer or its related parties.

<sup>40</sup> <http://www.eb5diligence.com/articles/in-eb-5-loan-administration-is-critical>; <http://www.dailybusinessreview.com/id=1202758383917/SEC-Case-Pushes-EB5-Focus-to-Oversight-Compliance?slreturn=20160824131417>.

Furthermore, the growing trend towards early release escrow<sup>41</sup> creates an opportunity for the NCE to directly control investor funds under its direct control for an extended period—many months to even a year or more—before the JCE has reached the stage that it is ready and entitled to the use of these funds. In some cases, this may provide the unscrupulous operator with more than ample time to divert the funds and cover his tracks.

Some might argue that as foreigners these investors are not deserving of investor protections. However, whether or not they are deserving, “bad actors” endanger the Program by continuing to prey upon EB-5 investors, with the opportunity to divert funds in the absence of a watchdog or government scrutiny.<sup>42</sup> Many EB-5 stakeholders also readily concede that the credibility of the Program is at stake, which by itself may place the Program’s existence at risk, both because of diminished investor interest and increased Congressional scrutiny.

The industry recognizes that integrity measures, compliance requirements, and investor protections are needed. The type and size of EB-5 projects radically changed in the period since the financial crisis. Until 2009, EB-5 was infrequently used as a capital source for real estate projects. However, since 2009 when USCIS liberalized its interpretation and permitted construction activity jobs to count to determine the size of an EB-5 capital raise, real estate development projects have become the dominant type of EB-5 projects. The total development costs of many of these projects have approached or exceeded \$1 Billion, with an EB-5 capital component often exceeding \$100M, and in a few cases, exceeding \$500M.<sup>43</sup>

Moreover, since USCIS modified its position in the mid-2000’s to permit EB-5 capital to be deployed as a loan, rather than as equity, loans have become the most common way to deploy the capital. Thus, these administrative interpretations have provided a valuable contribution towards EB-5 capital becoming a mainstream source of capital for real estate development projects. This provides a tremendous benefit to developers.

However, this structure also creates an opportunity for abuse that was not contemplated when the EB-5 laws were enacted. The EB-5 construction loan, whether structured as senior financing or subordinate mezzanine financing, is funded in multiple draws as the construction process progresses. Thus, vast sums of money are held by the NCE operator for an extended period of time until they are deployed by the NCE. This creates an opportunity for fund misappropriation that an unscrupulous operator might find too tempting to resist.

The EB-5 industry has proven to be unwilling to police itself.<sup>44</sup> This is not intended as an indictment of the industry as a whole. Many regional centers retain third party fund administrators, most notably NES Financial,<sup>45</sup> that provide a platform of investor protections. But even a few rotten actors can spoil the reputation of the entire Program. And the number and breadth of EB-5 enforcement actions to date suggests there may be more than a few. Thus, before it is too late, the government must mandate internal control requirements to be applied to this government-

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<sup>41</sup> <http://eb5arnstein.com/eb-5-investor-funds-merits-of-early-release-and-related-issues/> ; <http://www.eb5investors.com/blog/finding-balance-eb5-escrow-release-triggers> <http://www.klaskolaw.com/eb-5-investor-visas/the-evolving-landscape-for-eb-5-escrows/>

<sup>42</sup> As discussed above, USCIS does not review the flow of investor funds until the final stage of the EB-5 visa process, after the filing of the investor’s I-829 petition.

<sup>43</sup> <http://www.stern.nyu.edu/sites/default/files/assets/documents/EB5%20paper%20final%205.24.2015.pdf>

<sup>44</sup> In contrast, in the post-Madoff era, it has become common for hedge funds and private equity funds to retain third party fund administrators to perform and operational due diligence and oversee internal controls.

<https://www.bdo.com/getattachment/f68ef12f-add7-449a-8dfc-128fc296d264/attachment.aspx> ; <http://www.corgentum.com/research/the-madoff-effect-an-analysis-of-operational-due-diligence-trends.html>

<sup>45</sup> <http://nesfinancial.com/solutions/eb-5/>

administered immigration program, rather than hope the market will demand it.<sup>46</sup> This will protect the Program, with the incidental effect it will have upon investor protection. Inaction might lead to the demise of the Program.

### Support for fund administration controls

Coincidentally, the SEC enforcement action against Jay Peak was announced the day after the Senate Judiciary Committee Chairman, Senator Grassley, held a hearing on the need for Targeted Employment Area (TEA) reform.<sup>47</sup> Gary Friedland's paper dated April 24, 2016, setting forth his reflections on the hearing at which he testified, concluded with a call for action:

*"The focus of this Hearing was TEA reform. The day after the Hearing, the SEC announced the commencement of an enforcement action arising out of alleged fraud relating to the Jay Peak Resort in Vermont, one of the most prominent EB-5 projects. This case, and three other SEC actions commenced towards the end of 2015, have a common thread: diversion of EB-5 investors' funds. The alleged misappropriations occurred before the funds reached escrow, or after release from escrow but before invested in the project.*

*I suggest that the Integrity bill introduced in the Senate and House be amended to include a requirement that EB-5 funds be tracked by an independent third-party administrator, preferably in real time so that any violations can be detected immediately. This requirement should commence with the escrow period and continue throughout the immigration process until the funds are returned to the investor...These requirements might be more important than any other protections or safeguards mandated by the Integrity bills."*<sup>48</sup>

Subsequently, leading attorneys in the industry have echoed these statements, recognizing the need for integrity reform to incorporate fund administration controls. Some have urged even stronger Congressional measures to address the problem than those contained in the Account Transparency Requirement of H.R. 5992.

In a recent article, Catherine Debono Holmes, one of the nation's most well-respected EB-5 securities lawyers and a member of the EB5 Securities Roundtable,<sup>49</sup> pointed out that she and other securities attorneys had previously been focused on policies aimed at ensuring accuracy in the offering documents used to pool investor funds. However, as a result of the recent misappropriation cases, they realized the need to place more importance on the actual fund administration. *"It's not just about the offering, it's about what happens to the money after it's raised. And even after it goes into the hands of the developer ... what is the developer doing with the money?"* She suggested third-party monitors to oversee each stage of a project, and only to release funds as certain requirements are met.<sup>50</sup>

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<sup>46</sup> "Without a fraud risk profile, USCIS may not be well positioned to identify and prioritize fraud risks in the EB-5 Program, ensure the appropriate controls are in place to mitigate fraud risks, and implement other Fraud Risk Framework components." GAO Report dated September 13, 2016. <http://www.gao.gov/products/GAO-16-828>

<sup>47</sup> Senate Judiciary Committee Hearing held on April 13, 2016 entitled: "The Distortion of EB-5 Targeted Employment Areas: Time to End the Abuse."

<sup>48</sup> Gary Friedland, "Reflections on the Senate Judiciary Committee Hearing on EB-5: Time for TEA Reform," (April 24, 2016 at pages 14 and 15. Available at: <http://www.stern.nyu.edu/sites/default/files/assets/documents/EB-5%20TEA%20Reform%204.24.2016.pdf>

<sup>49</sup> The [EB5 Securities Roundtable](#) is an informal, independent group of EB-5 securities attorneys organized to facilitate best practices in the offerings of EB-5 securities

<sup>50</sup> <http://www.law360.com/articles/789747/jay-peak-eb-5-case-shines-light-on-need-for-fund-monitors>

Ronald Fieldstone, another well-respected EB-5 securities lawyers and also a member of the EB5 Securities Roundtable, stresses the need for transparency and financial accountability. He suggests a variety of best practices - *“essential for the integrity of the program”* - be implemented by EB-5 loan administrators, including such matters as: (a) requiring that the developer-borrower provide periodic financial statements prepared by an independent, certified public accountant and (b) maintaining a live website access showing the progress of construction.<sup>51</sup> In addition, Mr. Fieldstone warned: *“There is a need for more oversight and transparency.... If there is no independence in the administering and the distribution of the funds, it exposes the program to instances of fraud.”*<sup>52</sup>

Angelo Paparelli, a well-respected immigration lawyer who co-authored the first major article asserting that EB-5 capital is a security under the securities laws, paints a bleak picture of the problems plaguing the industry as a result of the lack of transparency, internal controls and investor protections:

*“Several widely-publicized actions by the Securities Exchange Commission (SEC), and the inevitable litigation that has piled on in consequence, have pressure-tested the EB-5 ecosystem and found it defective. Simply stated, the system too likely and too often fails. Sadly, many EB-5 investors, after writing half-million-dollar or greater checks, ultimately have learned that no balances remain in their capital accounts and no green cards land or stay in their own and their family’s wallets.*

*Stripped of cash and cards, an unacceptable number of EB-5 investors find out that they have been fleeced. This calamity is not necessarily attributable to the ever-present moral hazard of failing to thoroughly investigate a proposed investment, and imprudently placing at-risk funds into an unsound business opportunity. Rather, the flaw lies in structural and process failures of misfeasant government officials and market participants to take care that EB-5 investors are adequately protected from errant or unscrupulous promoters, developers, regional-center principals and migration agents, and from sundry Ponzi schemers, garden-variety fraudsters and sophisticated con artists.*

*No EB-5 stakeholders and the ecosystem itself cannot continue to thrive if too many investors are defrauded of money and the promised permanent residency. Clearly, a healthy, sustainable EB-5 ecosystem cannot endure without meaningful investor protections and reliable safeguards.”*<sup>53</sup>

Mr. Paparelli strongly recommended that Congress include in its forthcoming integrity measures a requirement that a regional center or developer engage an *“independent fiduciary - to protect the investment of EB-5 investors. An independent fiduciary would act much like a bank officer who decides whether agreed conditions have been satisfied before releasing progress payments of loan proceeds...The investors’ independent fiduciary would also perform an auditing function to confirm that required business and accounting records are maintained, and only permissible expenditures are paid,”* as well as a *“corporate secretary/treasurer functions to make timely disclosures to investors of financial activities, [and] monitor fund administration.”*

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<sup>51</sup> <http://www.eb5diligence.com/articles/in-eb-5-loan-administration-is-critical>;  
<http://www.dailybusinessreview.com/id=1202758383917/SEC-Case-Pushes-EB5-Focus-to-Oversight-Compliance?slreturn=20160824131417>. Also see the several excellent webinar series presented during 2015 and 2016 by Kurt Reuss of EB5Diligence that featured the importance of transparency and third party fund administration.

<sup>52</sup> <http://www.nytimes.com/2016/09/12/us/politics/visa-program-up-for-renewal-amid-allegations-of-fraud.html>.

<sup>53</sup> <http://www.nationofimmigrants.com/fraud-detection-national-security-fdns/all-checks-but-no-balances-the-systemic-failure-to-protect-eb-5-investors/>

According to Mr. Paparelli, “so too will a new system of checks and balances protect vulnerable EB-5 investors [and] likely reduce the prospect that investors will write very sizable checks but yield no balances in their capital accounts or place green cards in their wallets.”

At the July 28, 2016, EB-5 Stakeholder Engagement, IPO Chief Nicholas Colucci emphasized USCIS’s focus on enhancing the transparency and integrity of the Program, warning that fund misappropriation by regional center principals endangers the Program. Although self-policing is vital to Program integrity, Mr. Colucci warned that USCIS would continue to vigorously pursue bad actors in cooperation with the SEC and other law enforcement agencies. Finally, he asserted that the movement of funds between projects without notifying investors “*can jeopardize the very existence of the [P]rogram.*”<sup>54</sup>

## Account Transparency Requirement

This reflects our interpretation of the Account Transparency Requirement (“AT”) in light of the Background section of this article. We have tried to anticipate questions that stakeholders might raise when they focus on the AT controls.<sup>55</sup>

### Overview of requirements and goals

Before we provide a more detailed analysis of the requirements in Question and Answer format, here is a simple overview of the AT controls:

### Requirements - overview

1. The AT provisions impose controls on the flow of investor funds during the period beginning with the receipt of the EB-5 investor’s capital investment and ending with the transfer by the NCE to the JCE, unless the NCE and JCE are “affiliated.” If they are affiliated, then the controls continue until the funds are deployed into the project and verified by a third-party inspection.
2. The funds of all EB-5 investors in a single EB-5 project must be maintained by the NCE in one or more separate accounts at a regulated financial institution in the United States, not commingled with funds from any other source.
3. The NCE must give notice to USCIS, the EB-5 investors and the associated regional center in the case of the establishment of any separate account as well as any transfer of the funds.
4. The account balances must be available for on-line viewing on a continuous basis.<sup>56</sup>
5. Prior to any transfer of funds, an independent, qualified third party must approve the transfer in writing.

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<sup>54</sup>[https://www.uscis.gov/sites/default/files/USCIS/Outreach/Notes%20from%20Previous%20Engagements/PED\\_EB5NatStakeholderEng072816\\_ColucciRemarks.pdf](https://www.uscis.gov/sites/default/files/USCIS/Outreach/Notes%20from%20Previous%20Engagements/PED_EB5NatStakeholderEng072816_ColucciRemarks.pdf)

<sup>55</sup> For ease of reading, the article uses the present tense to describe the requirements and its impacts of AT, even though these provisions would not become effective unless a bill with AT provisions were passed and became law.

<sup>56</sup> See INA Section 203(b)(5)(P) to be added by H.R. 5992. All section references to H.R. 5992 refer to the new section to be added to the existing INA by the bill, rather than the section of the bill that contains the new section.

Note:

AT applies to the “capital investment” of an “alien investor.”<sup>57</sup> For ease of reference, we generally refer to the alien investor as the “EB-5 investor.” Furthermore, note that under AT, the funds implicitly retain their character as the capital investment of the alien investor even when the funds are commingled and pooled together with the funds of other alien investors in the same capital investment project, as permitted by the rules. We infer this because each of the AT provisions applies to the alien investor’s capital investment even after it is pooled and transferred from one account to another account.

## Goals - overview

The goal of AT is to provide some of the functions that might be served by a real-time watchdog with a minimum of intrusion upon, and cost to, the regional center, the NCE and JCE. AT obviously seeks to discourage the diversion of funds, but recognizes that diversion cannot be eliminated. If the diversion occurs despite the deterrence, AT provides a tool to detect and recover the funds as early as possible. Thus, the goals are: deterrence, early detection and enhanced discovery to increase the likelihood of fund recovery.

Here is an overview of how the requirements help accomplish these goals:

1. Deterrence
  - a. maintain the EB-5 investors’ funds for a single project in a separate account, not commingled with funds from any other source; otherwise it will be difficult to monitor and track such funds
  - b. provide notice to USCIS, investors and the regional center; the bad actor will be aware someone is watching - a watchdog, in contrast to the present system where USCIS performs no review until several years later, at the I-829 petition stage
  - c. access to view the investor’s account balance on-line from the outset; this is the tool to verify accuracy of notices
  - d. independent third party review and approval before any transfer of the funds
2. Detection
  - a. combination of notices and third party prior approval enables notice recipients to monitor and track the flow of funds and increase the likelihood that it will become aware of suspicious activity
  - b. third party review and approval provides real-time control by an independent party
  - c. on-line viewing of the account balance is an essential tool to verify the amount and location of the funds
3. Discovery and Recovery
  - a. the key to recovery is early detection and knowledge of the location of any diverted funds
  - b. starting with notice of the initial deposit of investor funds by the NCE, and continuing with release of the funds from escrow to the NCE and any subsequent NCE transfers, at least until transfer to the JCE, the notice recipients will be apprised of the funds’ location at a point subsequent to the initial deposit, enhancing

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<sup>57</sup> See, e.g., Sections 203(b)(5)(P)(i) and 203(b)(5)(P)(iii) to be added by H.R. 5992.

the tracking and location of the funds

## Questions and Answers (Q&As)

### Q&A – General

#### **Q: Which EB-5 entities must comply with AT?**

The AT controls are imposed upon all NCEs.<sup>58</sup> The controls generally do not apply to the JCE; however, AT applies to the JCE, if the JCE is “affiliated” with the NCE or regional center, as explained below. H.R. 5992 also imposes compliance and oversight responsibilities upon the regional center as “gatekeeper.”

#### **Q: Some laws provide an exemption for small companies. Are small projects or companies exempt from AT?**

No, all projects funded with any EB-5 capital are subject to AT. This recognizes that the potential for diversion of funds exists in any project. Some of the SEC enforcement actions have involved relatively small EB-5 capital raises.<sup>59</sup> On the other hand, many of the larger projects currently utilize third party fund administrators, such as NES Financial, that provide some of the AT protections as well as additional protections.

#### **Q: Does AT apply to all EB-5 investment structures whether deployed as a loan or equity?**

Yes, AT applies whether the EB-5 capital is deployed as a senior construction loan, mezzanine financing (debt or equity), preferred equity, or even an unsecured loan.

#### **Q: Does AT apply to EB-5 direct investment projects (those outside the context of the regional center program)?**

Yes, in EB-5 direct investments, the NCE is typically structured as an equity investment. The NCE and JCE may be the same entity. EB-5 direct projects represent a small percentage of EB-5 capital projects.

The manner by which the AT provisions would apply to investor funds in a direct investment deserves further analysis. We recommend that stakeholders involved in EB-5 direct investment consider any of the AT provisions that should be tailored to reflect more appropriate controls of the direct investment structure.

#### **Q: Does AT impose controls or responsibility upon the bank or financial institution at which the Separate Account is maintained?**

No, however, the bank’s compliance department might reflect these rules in the account agreement

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<sup>58</sup> See Section 203(b)(5)(P)(i) to be added by H.R. 5992.

<sup>59</sup> For example, in Zhong, EB-5 capital was raised from only 17 investors. Supra at Note 17.

with the NCE.

**Q: Does AT require an approval or other action by USCIS?**

No, AT requires that only notice be given to USCIS, as well as others, under various circumstances as described in these Q&As. (See the discussion of notice to USCIS in the Separate Account section of these Q&As.)

**Q&A - Separate Accounts**

**Q: How and where must the capital investment of an EB-5 investor be deposited?**

An NCE must deposit the capital investment of an EB-5 investor in a Separate Account.<sup>60</sup> (This definition is explained in the next Q&A below.) The Separate Account requirement applies whether or not the funds are deposited in a subscription escrow or outside of escrow.<sup>61</sup> H.R. 5992 does not require that the investor’s fund be deposited in an escrow.

The AT controls apply to the capital investment (typically \$500,000 under current law), but do not apply to the administrative fee paid by the EB-5 investor to the regional center.

**Q: What is a “Separate Account”?**

A “Separate Account” is defined as “an account-- (1) maintained in the United States by a new commercial enterprise at a Federally regulated bank or at another financial institution in the United States that is insured; and (2) that contains only the pooled investment funds of alien investors in a new commercial enterprise with respect to a single capital investment project.”<sup>62</sup>

Thus, the account must be comprised solely of EB-5 investors’ funds contributed to an NCE for a single capital investment project. These funds may not be commingled with funds from any other source, including, for example, funds of investors other than EB-5 investors. The commingling of EB-5 investors’ funds facilitates a bad actor’s scheme to divert the funds to prohibited destinations, and makes it difficult to monitor the flow of funds as they proceed to be integrated into the capital investment project.<sup>63</sup> The spaghetti map and related discussion included in the Background section of this article illustrates this point, as well as in certain other EB-5 misappropriation cases.<sup>64</sup>

Although the prohibition against commingling of funds may be inferred from other provisions of the existing EB-5 law, this provision makes it clear. Also, the definition does not limit the number of accounts that the NCE may maintain, although AT refers to “account” in the singular.<sup>65</sup>

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<sup>60</sup> Section 203(b)(5)(P)(i) to be added by H.R. 5992.

<sup>61</sup> See Section 203(b)(5)(P)(i) to be added by H.R. 5992.

<sup>62</sup> Section 203(b)(5)(P)(ii) to be added by H.R. 5992.

<sup>63</sup> Ponzi schemes involving commingling of funds were also alleged in Ramirez; Suncor; and Path America.. The commingling also complicates the ability to demonstrate to USCIS that the investment has been sustained, and the capital continues to be “at risk.”

<sup>64</sup> See Path America; and Zhong, *Supra* at Note 17.

<sup>65</sup> We suggest that the language be revised to reflect “one or more accounts.” It would not be surprising if an NCE maintains multiple accounts. Similarly, the section refers to an “alien investor.”

The funds must be maintained in an account in the United States. This requirement is intended to address instances where the funds were inappropriately transferred overseas, for example, to migration agents or for the principals' personal purposes.<sup>66</sup>

For these purposes, a "financial institution" has the meaning given to the term by Section 20 of Title 18 of the United States Code.<sup>67</sup> The institution must be insured and located in the United States. Thus, the funds may not be held in a foreign branch of a permitted institution.

Even if a Separate Account relates to only one investor or fewer than all EB-5 investors in the same capital investment project, arguably the notice required by this section should be sent to all EB-5 investors in that project. A diversion of fund relating to any investor adversely affects the ability of the project to be completed. Congress should consider this when revisions to H.R. 5992 are considered. The balance of the Q&As assumes that notice is to be sent to all EB-5 investors, not solely the investor whose funds are transferred.

**Q: Do the AT rules require that upon receipt the investor's capital investment be held in escrow? Why do the AT rules apply while the funds are held in escrow?**

H.R. 5992 does not change the existing law regarding escrow. That is, it does not impose an obligation upon the NCE to hold the investor's investment in an escrow account. However, it is very common for the investor's contribution to be held in escrow until a condition is met, typically tied to a stage in the immigration process. This provides the investor with protection that the NCE will have sufficient assets to fund the refund of the investment amount, if the investor's I-526 petition is denied.<sup>68</sup> We assume that escrow structures will continue to be widely used after the bill becomes law.

Even though H.R. 5992 does not require an escrow arrangement, the AT controls generally commence upon the NCE's receipt of the EB-5 investor's capital contribution. If the investor wires the funds directly to the bank which serves as escrow, the investor presumably knows the bank at which the funds are held. The funds are typically commingled with other EB-5 investor funds in the same capital investment project, but the account is titled in the name of, and for the benefit of the NCE.

The SEC enforcement actions to date demonstrate that the greatest opportunity for misappropriation occurs after the funds are released from escrow and until the funds are deployed to the JCE.<sup>69</sup> However, if Congress sought to delay the imposition of the AT controls until the release from escrow, this would have been much less effective.

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<sup>66</sup> See, e.g., Proton; and Suncor. Supra at Note 17.

<sup>67</sup> Section 203(b)(5)(P)(v)(ii) to be added by H.R. 5992.

<sup>68</sup> See pages 60 to 62 of

<http://www.stern.nyu.edu/sites/default/files/assets/documents/EB5%20paper%20final%205.24.2015.pdf>

<sup>69</sup> However, in at least two of the cases to date, all or some of the EB-5 investors' capital contributions did not even reach the subscription escrow account or were delayed in reaching the account, facilitating the misappropriation.

Ramirez; and Zhong. Supra at Note 17.

AT requires (1) the funds be held in a Separate Account, (2) notice of any transfer of the funds be given to USCIS, the EB-5 investors and the associated regional center, and (3) the prior written approval of an independent, qualified third party, as described in the relevant sections below. It is important that this requirement applies to the escrowed funds.

The ability to easily monitor the movement of funds requires that the party tracking the funds know the location of the funds from the outset. For example, USCIS and investors might not be able to monitor the location of the funds upon release from escrow because the funds could be released without the knowledge of USCIS and the investors. They would have no way of knowing whether the funds were still in escrow or released, the timing of the release, the destination of the funds and the amount of the funds that were released. Furthermore, depending on the escrow terms, the funds, at least theoretically, might be transferred from the original bank at which the escrow is held to another bank where the funds might continue to be held in escrow.<sup>70</sup> Even though the investor who wires funds directly to the bank at which the escrow is opened knows the bank location, the investor would not be aware of the new bank location.

If AT controls did not apply while the funds were held in escrow, then the Separate Account requirement would not apply. As explained above, the commingling of funds makes it easier for the bad actor to disguise funds, making it more difficult for the funds to be tracked. The notice required upon the original deposit and transfer to another account, such as a release of the funds from escrow, provides USCIS, the investors and the regional center with information about the new location of the funds. Finally, the prior written approval of an independent, qualified third party provides additional protections.

Thus, a bad actor intent on defrauding investors would be more easily able to circumvent the AT controls if the location of the funds were not tracked, and subject to the rules, from the time of the deposit in escrow.

One minor technical point: This section seems to assume that the investor's capital investment will be received by the NCE, rather than the regional center. Direct payment to the NCE (or escrow, if there is one) would be safer because the AT controls commence upon receipt by the NCE, directly or in escrow.<sup>71</sup> Although in most cases, the EB-5 investor wires his contribution directly to the bank escrow, in some cases the funds might be wired or mailed (in the case of a check) to the regional center.<sup>72</sup> To eliminate the potential for abuse by the regional center, Congress might consider requiring that the investor's contribution be sent to the NCE, rather than to the regional center.<sup>73</sup>

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<sup>70</sup> Although the escrow document might typically not permit the escrowed funds to be transferred to another bank escrow, without the investors' knowledge, a bad actor intent on diverting funds might transfer the funds from one escrow to another bank during the escrow period. In *Zhong*, all of the investors were Chinese, but some of the offering documents, including the subscription escrow was not translated to Chinese. The escrow document provided to the investors did not contain the name of the bank at which the funds were to be held in escrow. *Supra* at Note 17.

<sup>71</sup> Congress should consider clarifying this requirement.

<sup>72</sup> See *Ramirez*. *Supra* at Note 17.

<sup>73</sup> Alternatively, H.R. 5992 could apply the AT requirements to the receipt by the regional center of the investor funds.

**Q: The deposit of an EB-5 investor’s capital investment in a Separate Account triggers a notice requirement. When must the NCE give notice and to whom must notice be given?**

Notice must be given “prior to, or within one business day, of the deposit.” Notice must be given to the alien investor,<sup>74</sup> USCIS and the associated regional center.<sup>75</sup>

**Q: Why must notices be given to USCIS?**

The unscrupulous regional center or NCE operator knows, under the current system, no one is watching its handling of investor funds. As described in the Background section of this article, USCIS does not scrutinize the flow of funds until after the I-829 petition is filed, which does not occur until several years after the EB-5 investor makes his capital contribution. In many cases, the EB-5 investor does not receive periodic reports about the status of the funds from an independent third party. Thus, the bad actor knows that no real time watchdog exists, which may further embolden him to divert funds.

AT requires that the NCE give notice to USCIS, in addition to the EB-5 investors and the associated regional center, under various circumstances. These circumstances include: upon deposit of the EB-5 investors’ funds in a separate account, and the transfer of these funds from the separate account to any other account maintained by the NCE until the funds are deployed to the JCE. This is further described in the Q&As below.

One purpose of requiring that notice be given to USCIS is to have a deterrent effect on those inclined to divert the funds. They would know that USCIS is monitoring, or at least has the ability to monitor, the location and flow of funds. Additionally, if USCIS were to receive a complaint or be suspicious that the funds have been diverted, this would help it track the location of the funds.

Rather than impose a burdensome and time-consuming approval or review process with USCIS, AT merely requires that notice be given to USCIS. We do not necessarily anticipate that USCIS will dedicate personnel to reviewing routine notices filed pursuant to AT. This recognizes that even the most diligent USCIS specialist is unlikely to discern that a transfer of funds is suspicious, based merely on a notice given pursuant to AT. The government official may be unfamiliar with many details, such as the terms of the investor’s petition, the business plan and the offering package.<sup>76</sup> Presumably, USCIS will maintain a database of the notices received. (As discussed below, in our view the investors and the independent third party inspector are the keys to detection.)

Thus, USCIS will incur minimal cost to implement and maintain the procedure. In the long term, the government should reap substantial savings. If and when claims of misappropriation and

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<sup>74</sup> We suggest that the section be revised to reflect the “alien investors,” so the notice is sent to all EB-5 investors in the same project. A separate notice can be sent to each investor via a mass distribution list that does not disclose the identities of the other investors.

<sup>75</sup> Section 203(b)(5)(P)(i)(1) to be added by H.R. 5992.

<sup>76</sup> This can be more effectively performed as part of an audit or site visit, or as part of the review of the annual statement, Form I-924A.

related frauds arise, the information provided by the NCE will assist the investigation and enable government investigators to more quickly isolate the accounts and transfers, and locate the funds.

**Q: Does notice have to be provided to the regional center?**

Notice must be given to the associated regional center. This requirement is consistent with the regional center’s role as “gatekeeper,” and the many responsibilities imposed upon the regional center pursuant to the integrity and compliance provisions of H.R. 5992.

The notice is required whether or not the regional center is related to the NCE. By itself, without notice going to investors and USCIS, notice would be unlikely to be effective as a deterrent or to result in early detection in the common structure where the regional center and NCE are related because any scheme to divert funds would probably involve both entities. In such case, notice would be even more unlikely to be effective where the regional center, NCE and JCE are related (for example, in the case of an in-house regional center), because in most cases all three entities would be parties to the scheme.<sup>77</sup>

Early detection of a diversion is the most effective way to stop the diversion, and to enhance the government’s ability to discover the location of the funds and then recover them. The longer the bad actor/the separation in time between diversion and detection, the greater the opportunity for the funds to be hidden in remote locations, and difficult to locate.<sup>78</sup>

**Q: Why must notices also be given to the EB-5 investors?**

Some regional center and NCE operators might question the rationale behind the requirement to give notice to EB-5 investors as their funds move through the initial life cycle of a project.

AT recognizes that the EB-5 investor is in the best position to deter and detect the misappropriation of funds, much better than USCIS. AT is predicated on the vital role that the EB-5 investors can play. The EB-5 investor is at risk and has the most to gain or lose in the case of misappropriation.

When “skin in the game” is referred to in the real estate finance context, one ordinarily focuses on whether the developer has a sufficient financial stake in the project (skin in the game) to satisfy the lender’s requirement to take on the investment risk. However, EB-5 investors may have more skin in the game than the developer. Not only do they risk losing their financial investment (their equity contribution), they also risk losing their sought after lifestyle – permanent residency for them and their family members in the United States.

They make a capital investment of at least \$500,000 in the NCE. More importantly, it is critical to the investor that the funds reach the JCE and are integrated into the project because visa

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<sup>77</sup> In the case of a rental regional center arrangement, the regional center (the “license”) is rented to an unrelated third party that will form and manage the NCE, that may or may not be related to the JCE. Given the securities compliance requirement imposed by H.R. 5992 it is likely that rental arrangements will become less prevalent after H.R. 5992 becomes law.

<sup>78</sup> In Zhong, the diversions started in 2012, and the SEC enforcement was not filed until 2015. Even though the diversion in Jay Peak started in 2008, the SEC enforcement action was not filed until 2016. <http://www.dfr.vermont.gov/sites/default/ext/sl/dev/img/Timeline%20of%20Alleged%20Activity%20Involving%20Jay%20Peak%20EB-5%20Projects.png>

approval – their reason for making the investment – is largely dependent on the completion of the project. Thus, the EB-5 investment is likely to be as, or more important than, any investment they make for a financial return. Collectively, the investors often have a greater financial stake in the project than the developer (and that does not even take into account the “visa risk”).

The investors have a self-interest in making sure the funds are properly handled because their visa and capital are at substantial risk. Thus, the EB-5 investor is highly motivated to track the activity of the project and the flow of investor funds. Their motivation has been heightened by the publicity surrounding the numerous EB-5 fraud cases in the United States.

The individual investors are also in a much better position than USCIS to be familiar with, and to appreciate, the project details as the project proceeds through its life cycle, including construction status and project financing. Obviously, the investor will track the status of his I-526 petition as it proceeds through the immigration process, and presumably coordinate this with any escrow release terms.

Jay Peak demonstrates that the EB-5 investor might detect fraud before the Federal and state regulators, and increase the chance that the misappropriated funds will be discovered and then recovered. In that case, one of the EB-5 investors discovered the fraud perpetrated by the developers (the managers of the NCE and developers of the JCE) primarily due to his access to information gained by communicating via email with other investors.<sup>79</sup>

The AT controls provide significantly more information to the investor than the very limited information that was available to the Jay Peak investors. This information will contribute to deterring the diversion of funds and early detection, if funds have been diverted. Notice to the investors increases the likelihood that the NCE will provide accurate information because it realizes that a watchdog with knowledge of the project is monitoring the movements of funds.

**Q: Does this notice requirement apply only to the initial deposit by the NCE of an investor’s capital, or does it also apply to the deposit of the funds pursuant to certain transfers of the funds?**

The notice of deposit requirement applies to a deposit made pursuant to certain transfers of the funds. As discussed above, for these purposes, the investor’s funds retain their character even after the funds are commingled and transferred to another Separate Account or to the JCE, the funds in a Separate Account may be transferred only to the EB-5 investor as a permitted refund (if otherwise compliant with EB-5 law and regulations), “to another” Separate Account, to a JCE or otherwise deployed into the intended capital investment project, as described in a separate Q&A below.<sup>80</sup> The Separate Account definition requires that the funds be maintained by the NCE. Thus, the deposit of the funds into another Separate Account pursuant to a transfer of the funds from the existing Separate Account requires that the NCE provide the notice of the deposit into the new account. Congress should clarify whether this information should be included in the same notice as the notice of the transfer of funds described below.

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<sup>79</sup> <http://digital.vpr.net/post/meet-london-car-dealer-who-broke-jay-peak-eb-5-fraud-case#stream/0>

<sup>80</sup> Section 203(b)(5)(P)(iii)(i)(AA) to be added by H.R. 5992.

An example of a covered transfer would include a deposit made pursuant to a release of the funds from the subscription escrow into an NCE account outside of escrow. As discussed below, in connection with the transfer of funds, a notice would be required pursuant to AT. We suggest that Congress consider clarifying the notice of deposit provision or notice of transfer of funds provision to reflect this.<sup>81</sup>

**Q: What information must be provided in the notice relating to the deposit of the EB-5 investors' funds?**

Three types of information must be contained in the notice:

- (1) The name, address and other contact information of the bank or other financial institution where the Separate Account will be maintained;
- (2) The independent, unrelated qualified individual who is designated by the NCE to serve as the “authorized signatory” whose prior written consent is required as a condition to the proposed transfer of funds from the Separate Account; and
- (3) Sufficient information to enable the investors, the regional center and USCIS to view online the balance in the Separate Account on an ongoing basis.<sup>82</sup>

The requirements pertaining to the authorized signatory are explained in the Transfer of Funds section below.

Although this could likely be clarified through USCIS-issued regulations, Congress should also require that the name or title of the account be specified in the notice. In the case of an escrow, presumably the account title would include the name of the NCE, and indicate that the account is for the benefit of the NCE. If the account is maintained outside of escrow, then presumably it would be titled in the name of the NCE. If the account were in the name of an individual owner or officer this would be suspicious.<sup>83</sup>

**Q: Why does AT require that USCIS, the investors and the regional center have access to on-line viewing of the balance in the Separate Accounts?**

AT requires that the NCE give notice of the balance in the account upon account creation and upon a transfer of funds to a new account. It would be preferable if the bank or institution were required to provide such notice because the financial institution is more reliable, and unlikely, to provide false or misleading information. However, AT recognizes that banks might be reluctant to assume that responsibility, even for a fee. Fewer than one percent of the 6,414 regulated banks are willing to serve as an EB-5 escrow.<sup>84</sup> The imposition of additional obligations upon banks might make it even more difficult to induce banks to hold EB-5 funds, especially in an escrow account. On-line viewing provides the most effective way to verify the balance, to deter the NCE from diverting the funds and to enable early detection of any diversion.

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<sup>81</sup> See Section 203(b)(5)(P)(ii)(I) to be added by H.R. 5992.

<sup>82</sup> Section 203(b)(5)(P)(i)(I) and 203(b)(5)(P)(i)(II) to be added by H.R. 5992.

<sup>83</sup> In one case initiated by a whistleblower, EB-5 investor funds were allegedly diverted to an officer to pay the personal income tax liabilities of one of the officers. <http://www.vnews.com/Seldon-Technologies-lawsuit-claims-EB-5-via-program-financial-mismanagement-at-former-water-filtration-device-maker-2468881>

<sup>84</sup> Data is as of 2015. <https://iiusa.org/blog/eb5-retrospective-approached-successful-eb5-banking/>;  
<https://www.fdic.gov/about/learn/learning/aboutfdic.html>

Access to the bank account balances provides a quick and easy way to verify that the funds have moved to the intended destination. Without this requirement the operator can provide information that is inaccurate, and the inaccuracy might not be revealed until it is too late.

On-line access is essential to verify the accuracy of the information given by the NCE.<sup>85</sup> If this information were provided by the bank or an independent fund administrator, this tool would not be as critical. The underlying themes of the Federal securities laws – transparency and full disclosure – support this access. In today’s world, it is common for investors to access on-line their account balances and transfers in order to monitor the activities of their securities and other investments. Thus, H.R. 5992 appropriately utilizes on-line access for a limited purpose consistent with the underlying themes of the Federal securities laws – transparency and full disclosure.

**Q: Does access to the on-line balance relate to the internet site maintained by the bank where the account is maintained, rather than the NCE?**

We suggest that this provision be clarified to require that the information provided enables the investor and other recipients “to view online the balance in the separate account” refer to the internet site maintained by the bank or financial institution at which the account is located. (This would be similar to the manner in which a bank depositor or securities investor can check his account balance on-line.) Otherwise, this provision might be misinterpreted to mean that the NCE could post the account balance on line, which would frustrate the verification purpose to be served by providing access to the on-line account information. This verification is particularly important for a release from escrow or subsequent transfer because the investor would not otherwise be able to verify that the funds have reached the new account.

**Q: By what means is notice to be given to USCIS, the EB-5 investors and the regional center?**

AT provides that all notices or other information “may” be given via electronic mail. We assume most NCEs will choose this method because it is efficient, simple and avoids mailing costs. The NCE can set up a mass distribution list, and email separate notices to each of the recipients without including the email address of the other recipients. Regulations might address this in more detail, including alternative ways to provide notice. USCIS should consider that alternative methods may be less reliable and take longer for the investor to receive, thereby potentially frustrating the purpose of the notice.

**Q&A - Transfer of funds from a Separate Account**

**Q: Where may investor funds in a Separate Account be transferred?**

The funds in a Separate Account may be transferred only to:

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<sup>85</sup> Access can be provided with minimum intrusion on the NCE’s privacy. The viewer does not need the entire account number of the account to gain access.

1. The EB-5 investor who contributed the funds “as a refund of that investor’s capital investment if otherwise permitted under” section 203(b)(5);
2. “[A]nother Separate Account”;
3. A JCE; or
4. “[o]therwise deployed into the project for which the funds were intended”.<sup>86</sup>

The aim of this restriction is to limit the destinations to which the funds may be transferred. This implicitly prohibits the funds from being used for any other purpose for any period of time.

The existing EB-5 statute and applicable USCIS rules and regulations determine whether the refund will be permitted. This is straightforward.

The transfer “otherwise deployed into the project for which the funds were intended” is presumably included as a catch-all that applies to the situations not covered by the other categories. For example, it may apply to EB-5 investor funds invested as equity directly in a capital investment project. This applies to an equity investment under the EB-5 regional center program or as a direct EB-5 investment.<sup>87</sup>

The most common transfers will be a transfer to another Separate Account or to a JCE.

**Q: What type of transfers fit into the category of a transfer of funds from a Separate Account to “another Separate Account?”**

Examples of a transfer of funds to another Separate Account include: a release of the funds from the subscription escrow to the NCE’s account outside of escrow; and a transfer of the funds from that account outside of escrow to another Separate Account, such as a transfer to another account that offer higher interest rates, or a draw down account from which funds will be transferred before the funds are deployed as a loan to the JCE via multiple advances.

**Q: Are any approvals or consents required prior to the proposed transfer of funds from a Separate Account?**

Yes, the prior written consent for the proposed transfer must be obtained from at least one “authorized signatory” who meets the qualifications set forth in AT.<sup>88</sup>

**Q: Who may serve as an authorized signatory from whom consent is required before a transfer is permitted?**

The signatory must be an individual who (1) is independent and unrelated to the NCE, JCE or regional center or the managers or principals of the entities, and (2) meets other eligibility requirements. AT does not limit the qualifications of the other individuals who may serve as authorized signatories to a Separate Account. It simply sets forth the qualifications for the signatory whose consent must be obtained before a transfer may be made. For ease of

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<sup>86</sup> Section 203(b)(5)(P)(iii) to be added by H.R. 5992.

<sup>87</sup> USCIS may choose to define this type of transfer in regulations.

<sup>88</sup> Sections 203(b)(5)(P)(iii)(I)(bb) and 203(b)(5)(P)(ii)(II) to be added by H.R. 5992.

understanding, we will refer to this individual as the “Independent Signatory.”

Specifically, the Independent Signatory must be: “independent of, and not directly or indirectly related to” the NCE, the JCE or regional center, “or any of the principals or managers of such entities.” This requires that at least one of the signatories be independent and unrelated to the EB-5 entities or any of their principals or managers. Obviously, this provision addresses the several misappropriation cases where the principals of the NCE (typically the owners of the related regional center) were the only signatories to the bank accounts (escrow or outside of escrow).<sup>89</sup>

Independent third-party review should serve as the best deterrent to unlawful diversions. Obviously, the effectiveness of this control will depend upon the independence and qualifications of those who serve in this capacity. It should be noted that, as a practical matter, the independent and unrelated signatory will be selected, and presumably compensated, by the NCE, JCE or regional center.

The following individuals are eligible to serve as the Independent Signatory: (1) “an officer at the bank or other financial institution where the separate account is maintained;” or (2) “licensed, active and in good standing...attorney, certified public accountant, or broker-dealer.” In addition, an eligible individual includes anyone who is “otherwise authorized” by USCIS to serve as a signatory.

If the bank officer is willing to serve as the Independent Signatory, this would be a good choice because the bank will be sensitive to compliance with banking regulations as well as EB-5 rules and regulations.<sup>90</sup>

An attorney, certified public accountant or broker dealer will also be sensitive to compliance with the rules and regulations of their respective professions, as well as EB-5 rules and regulations. Arguably, the broker-dealer would seem to be the most appropriate to serve as an Independent Signatory because the services it regularly provides are of a similar nature to the oversight of the EB-5 investors’ funds.

Technically, the broker dealer is “registered” (by SEC and FINRA) rather than licensed. Furthermore, the specific types of individuals who must perform the services on behalf of the broker-dealer should be indicated.

We expect that USCIS will promulgate rules and regulations to specify other categories of professionals who may be eligible to serve as an Independent Signatory, rather than establish a case-by-case approval process. For example, it may permit registered investment advisers to

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<sup>89</sup> Arguably, the phrase “principals or managers” is unnecessary because the modifier “directly or indirectly” placed before the list of EB-5 entities captures anyone who is related to the principals or managers. Also, the inclusion of principals or managers may be construed as a limitation on the scope of the restriction. Further thought might be given to the wording of this restriction.

<sup>90</sup> By permitting the bank officer to serve in this capacity, the language implies that the bank at which the account is maintained is independent and unrelated to the EB-5 entities for this purpose. Perhaps this provision should be modified to prevent individuals from other companies to claim that they are independent and unrelated even though they have a preexisting relationship to the EB-5 entities.

serve in this role.

As part of the review process, the Independent Signatory will gain information about the relevant Separate Accounts – where the funds are currently located and their destination. This should prove valuable in the case of any future investigation.

**Q: The transfer of funds from a Separate Account triggers a notice requirement. When must the NCE give notice and to whom must notice be given?**

The timing of the notice is similar to the timing of notice of a deposit. Notice must be given “prior to, or within one business day, of the” transfer. Notice must be given to the alien investor,<sup>91</sup> USCIS and the associated regional center.<sup>92</sup>

**Q: What information must be provided in the notice relating to the deposit of the EB-5 investors’ funds?**

The notice must contain the following information:

1. “The amount of the funds” transferred or to be transferred; and
2. “[T]he destination of the transferred funds, including whether the funds are transferred to another separate account, or transferred directly to the job creating entity or otherwise deployed into the capital investment project for which the funds were intended.”<sup>93</sup>

We suggest two minor changes to the required contents of the notice. First, the only other permitted destination – a refund of an EB-5 investor’s capital contribution – should be listed as a possible destination to be stated in the notice. Secondly, in the case of any transfer from one Separate Account to another, the notice should state a more specific reason for the transfer. For example, specify the purpose for which the funds were transferred: as a release from escrow; or to a draw down account established by the NCE to hold funds for the future deployment as a loan to the JCE.<sup>94</sup>

## **Q&A - Transfer of funds to an Affiliated JCE**

**Q: Upon a transfer of a funds to a JCE, are the funds still subject to AT?**

Generally, once the EB-5 investors’ funds reach the JCE, the funds are no longer subject to the AT controls. However, if the JCE is related to the NCE – specifically, if it constitutes an affiliated job creating entity (an “AJCE”), then additional AT controls apply.

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<sup>91</sup> Again, we suggest that the section be revised to reflect the “alien investors,” so the notice is sent to all EB-5 investors in the same project.

<sup>92</sup> Section 203(b)(5)(P)(i)(1) to be added by H.R. 5992.

<sup>93</sup> Section 203(b)(5)(P)(iii)(II) to be added by H.R. 5992.

<sup>94</sup> Furthermore, Congress should consider whether, in the case of a transfer to another Separate Account, the notice may combine the above information with the information required in the case of a notice of a deposit in a Separate Account (that is, the new bank’s contact info and the on-line access information) described above.

For these purposes, the AJCE definition is the same as that for the securities compliance and other integrity requirements. An AJCE is defined as any JCE “that is directly or indirectly controlled, managed or owned by any of the persons involved with” the NCE or JCE.<sup>95</sup>

**Q: Why do AT controls continue to apply after the EB-5 investors’ funds are deployed to the JCE only if it constitutes an AJCE?**

The misappropriation cases to date have involved related parties – where the manager of the NCE and JCE were related by common ownership and/or management.<sup>96</sup> If AT controls were not to continue after the transfer to the AJCE, this might create an incentive for a bad actor – the principals of the NCE- to transfer the funds as quickly as possible to the AJCE to circumvent AT. This would have frustrated the purpose of AT by creating an easy opportunity for the principals to misappropriate the funds before their integration into the project, thereby complicating the ability to track and locate the diverted funds.

The AT controls could have extended to all JCEs rather than only AJCEs; however, by limiting the application to an AJCE, Congress decided to restrict the scope of this requirement. The opportunity to circumvent is not as relevant in the case of an unrelated NCE and JCE (a JCE that does not meet the AJCE definition) because the NCE will not have the same motivation to prematurely transfer the funds to an entity that does not benefit the NCE. Furthermore, the unrelated JCE developer is more likely to complain and possibly contact USCIS if the EB-5 capital is not funded (whether as a loan or equity) to the JCE in a timely manner, especially if the project is ready for the proceeds, the unrelated JCE has reason to believe that the investors’ funds have been contributed to the NCE and the escrow release trigger has been met.

**Q: What requirements are imposed upon the AJCE in the case of a transfer of EB-5 investor funds from a Separate Account?**

The following requirements apply in the case of a transfer of EB-5 investor funds from a Separate Account:

1. The funds shall be maintained by the AJCE in a “separate account that meets the requirements of this section until the funds are deployed into the capital investment project for which they were intended”;
2. Within 30 days of the deployment, an independent qualified signatory shall verify that the funds were deployed as required; and
3. Notice of the verification shall be sent to USCIS, the EB-5 investors and the regional center.

**Q: Is the separate account requirement (#1 in the above Q&A) for the AJCE the same as the separate account requirement for the NCE?**

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<sup>95</sup> This definition is appropriately broader than the AJCE definition contained in the Integrity bill. We believe this definition should be even broader. However, a further discussion of this definition is beyond the scope of this article.

<sup>96</sup> In all of the cases except Jay Peak, the regional center has also been related to the NCE and JCE.

Based on the language of the requirements that apply to the funds held by the AJCE, it appears that Congress intended that the AJCE meet the same requirements as apply to a deposit received by an NCE. These requirements include: (1) the type of financial institution where the account may be maintained; (2) no commingling of funds; (3) notice of deposit of the funds, including on-line access; and (4) restrictions on transfer of the funds.<sup>97</sup>

One minor technical point is the definition of a Separate Account under the AT controls requires that it be maintained by an NCE.<sup>98</sup> Obviously, in this case, the account would be maintained by the AJCE.<sup>99</sup>

The separate account requirement continues to apply to the AJCE until the funds are “deployed” into the project and the deployment is verified as required. H.R. 5992 does not define “deploy.” Neither do the existing statute or USCIS rules or regulations. The apparent purpose of the AT controls continuing until the funds are “deployed” into the project is to protect the investors and ensure the completion of the project, rather than be diverted by the AJCE to a prohibited destination. Obviously, the mere maintenance of the funds in the AJCE’s bank account does not constitute deployment because otherwise the Separate Account requirement would not be necessary. Unless the meaning is clear, “deployed,” should be described or defined, at least for AJCE purposes. For example, deployment might require integration or incorporation into the project. However, the nature of the deployment may vary depending on the particular type of capital investment project.

**Q: Who may serve to verify that the funds are deployed into the project?**

AT authorizes the same individuals who may serve as the authorized signatory to consent to a proposed transfer of funds from an NCE to serve to verify the deployment of funds. As explained in greater detail in the the Q&A above about transfer of funds, the signatory must be an individual who (1) is independent and unrelated to the NCE, JCE or regional center or the managers or principals of the entities, and (2) meets other eligibility requirements. For ease of reading, we will refer to the individual as a “Verifier.” Similar to the Independent Signatory, the Verifier will serve to deter and detect unlawful diversions.

The requirement that the individual be independent of, and not related to, the EB-5 entities is appropriate.

However, Congress should reconsider whether the listed professionals are the most appropriate individuals to serve this purpose. In most cases, the EB-5 investor funds will be used to fund construction and related costs of the project. In that context, deployment presumably can be verified by inspecting the project to determine whether the relevant work has been completed.

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<sup>97</sup> See Section 203(b)(5)(P) to be added by H.R. 5992.

<sup>98</sup> Section 203(b)(5)(P)(v)(II)(aa) to be added by H.R. 5992.

<sup>99</sup> As discussed in the Separate Account Q&As above, the destination of the funds held in a Separate Account are limited. The funds may be “deployed” into the capital investment project for which the funds were intended. Thus, this AJCE requirement is consistent with the requirement imposed upon the NCE.

An accountant, attorney or even a broker-dealer might not be appropriate to verify deployment for these purposes. A more appropriate person to verify this might be a qualified construction consultant.<sup>100</sup> Alternatively, an inspection of the work by an independent qualified professional may be implicit in the provision as drafted. In addition, the Verifier qualifications should reflect that the method to verifying deployment of the funds may differ if the funds are not intended to be deployed to fund construction related expenses.

If this provision is retained as drafted, we propose the same revisions as those we proposed for the authorized signatory in the relevant Q&A above.

We expect that USCIS will promulgate rules and regulations to specify other categories of professionals who may be eligible to serve as a Verifier, rather than establish a case-by-case approval process.

It should be noted that, as a practical matter, the independent and unrelated Verifier will be selected, and presumably compensated, by the NCE, JCE or regional center.

**Q: AT requires notice that the funds were deployed into the project be given to USCIS, the EB-5 investors and the regional center. Who must give this notice?**

The notice must be given by the individual who verifies the deployment of the funds, not the AJCE. This is stated in the same sentence of the provision that describes the individual who may verify the deployment.<sup>101</sup> We suggest that Congress consider requiring that the AJCE rather than the Verifier give this notice.

**Q: Do AT controls apply after the project is completed and the EB-5 investor funds are repaid (in the case of a loan) or distributed (in the case of an equity investment) to the NCE?**

No, AT controls do not apply after the transfer of the funds to the JCE, unless the JCE constitutes an AJCE. As described above, even in the case of the AJCE, the restrictions do not apply after the funds are deployed into the project and verified. The controls stop at this point even though the immigration process will not have been completed, and unconditional permanent residency and recovery of capital are still at risk.

The risk of the misappropriation of funds continues well after the funds are deployed. The funds are subject to diversion until the funds are fully recovered by the EB-5 investor. Redeployment of the funds by the NCE after recovery of the funds from the JCE, as required by current USCIS

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<sup>100</sup> If the senior construction loan is made by a regulated bank or financial institution, the professional who inspects the work on behalf of the senior lender might be appropriate to verify the deployment for the AJCE. The senior lender typically conditions its funding of the senior loan upon the prior funding by all other capital sources. Some construction lenders require a “sign off” before senior loan draws are funded to the project entity to make sure the work funded by the mezzanine loan proceeds is actually in place and to ensure the construction loan is “in balance” (that is, sufficient funds are available to complete the project.)

<sup>101</sup> Section 203(b)(5)(iii)(III) to be added by H.R. 5992.

rules, poses additional risks.<sup>102</sup> However, we believe Congress exercised good judgment by limiting the AT controls to the period when the greatest risk of diversion of investor funds exists. The wise EB-5 investor will retain a third party consultant to continue to monitor the project and transactions until his funds are recovered in full.

## Q&A - Sanctions

### Q: What sanctions are imposed if an NCE or an AJCE violates AT?

It is unclear as to which, if any, sanctions would apply. H.R. 5992 authorizes the Director of DHS to sanction a regional center entity if it is “conducting itself in a manner inconsistent with its designation... including any willful, undisclosed, and material deviation by a new commercial enterprises (sic) from any filed business plan for such commercial enterprises.”<sup>103</sup> The bill should be clarified that this extends to a violation of AT.

The sanctions against the regional center added by H.R. 5992 include a fine, suspension or termination of the regional center designation.<sup>104</sup> The fine is limited to 10 percent of the total EB-5 capital invested in the regional center’s NCE or JCE. If this is the sanction that is intended to apply to a violation of AT this seems woefully inadequate because the amount diverted might greatly exceed that monetary sum. Presumably, this sanction (which is a carryover from S. 1501) does not take into account AT. In addition, assuming Congress has the power to impose sanctions against the NCE and its principals, the sanctions should be broadened to properly sanction them for a violation of the AT. In many cases, the acts or omissions that constitute the violation of AT by the NCE and its principals, as issuer and controlling persons, respectively, might also constitute a violation of the Federal securities laws. This would expose them to liability, as issuer and controlling persons, respectively. However, H.R. 5992 should consider imposing civil and criminal liability, including personal liability if appropriate, independent of, or coordinated with, the liability imposed by the securities law.<sup>105</sup>

## Q&A - Effective date

### Q: What is the effective date of AT?

The effective date is delayed. H.R. 5992 provides that AT shall “take effect one year after” the enactment date of the law and shall apply to any application filed by a regional center for approval of an investment under new Section 203(b)(5)(I)<sup>106</sup>, filed “on or after such date.”<sup>107</sup> Thus, it appears that the earliest AT would apply to a regional center and associated NCE is at least one year after the effective date of the law. Assuming the new law were enacted December 9, 2016 (a not too

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<sup>102</sup> See

[https://www.uscis.gov/sites/default/files/USCIS/Outreach/Draft%20Memorandum%20for%20Comment/PED-Draft Policy Memo Guidance on the Job Creation Requirement and Sustainme.pdf](https://www.uscis.gov/sites/default/files/USCIS/Outreach/Draft%20Memorandum%20for%20Comment/PED-Draft%20Policy%20Memo%20Guidance%20on%20the%20Job%20Creation%20Requirement%20and%20Sustainme.pdf)

<sup>103</sup> See Section 203(b)(5)(J)(iii)(I)(bb) to be added by H.R. 5992.

<sup>104</sup> See Section 203(b)(5) (J)(iii)(II) to be added by H.R. 5992.

<sup>105</sup> The remedies under the Federal securities laws include fines and disgorgement as well as criminal punishment.

<sup>106</sup> The investment approval process replaces the existing law’s exemplar process, and makes it mandatory for any new project investment. See Section 203(b)(5)(I) to be added by H.R. 5992.

<sup>107</sup> Under the Bill, the investor’s I-526 petition could not be filed until the application for investment is filed by the regional center. Section 203(b)(5)(I)(i) to be added by H.R. 5992.

likely event), then the earliest an NCE might be subject to AT would be December 9, 2017.<sup>108</sup>

However, it is likely that the effective date would be delayed even further. Until the law is enacted, it will not be known whether many investors will be inclined to subscribe to, and invest capital in, a project before USCIS grants approval of an investment for the project under the new rules. In addition, many investors are likely to prefer to invest in the hundreds of projects that have already received exemplar approval and started to raise funds before enactment of the new law, especially if construction activity has already commenced.

Furthermore, if AT will not apply to existing NCEs that have raised or are in the process of raising capital, then hundreds of existing NCEs holding EB-5 capital will be able to escape AT, a provision that is critical to restoring integrity to the Program. Thus, if Congress believes that AT will be an effective method to deter the misappropriation of investor funds, Congress should accelerate, rather than delay, the effective date of AT controls. The sooner AT controls are implemented, the greater the likelihood that misappropriations might be deterred or detected. The Program may not be able to survive another major fraud.

## EB-5 Stakeholder Comments

Given that H.R. 5992 was introduced on September 12, 2016 (less than a month ago), many in industry are concentrating their efforts on the more controversial provisions of the bill relating to retroactivity, visa set-asides and other TEA reform provisions. The AT provision is likely to generate many comments because it is a new concept, and one of the few provisions in H.R. 5992 that was not included in, or based on provisions, in either S. 1501 or the Integrity bill. Thus, some aspects of the AT controls are likely to change prior to the law's enactment. Also, H.R. 5992's passage is unpredictable due to the controversial nature of EB-5 reform in general.

We expect that EB-5 stakeholders will support the AT concept and its goals, particularly in light of the threats posed to the Program by the mounting number of fraud and abuse cases. However, some stakeholders, particularly regional centers and professional service providers, are likely to comment and may point out practical deficiencies that will warrant appropriate changes to AT. Perhaps, an independent fund administrator will be able to provide similar protections in a more cost-efficient manner. It is possible that best practice procedures already implemented by some regional centers and NCEs might be as protective as AT. If that is the case, it would not be surprising if they sought an exemption from AT.

Also, the SEC and state regulators, as well as any appointed receivers, might provide comments because they are in position to determine the most effective controls to be implemented.

Obviously, no law will eliminate all fraud or the misappropriation of funds by those bad actors who are determined to circumvent the law. H.R. 5992 sets forth the minimum standards that will apply to the movement of EB-5 investor funds. EB-5 investors might be inclined to favor projects that utilize third party fund administration and establish internal controls that go

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<sup>108</sup> The Continuing Resolution ("CR") signed by President Obama on September 29, 2016 reauthorized the Program until December 9, 2016. <https://www.congress.gov/114/bills/hr5325/BILLS-114hr5325eas.pdf>. However, as of the date of this article, questions have been raised as to whether the CR validly extended the Program. <http://www.natlawreview.com/article/congressional-research-service-analyzes-validity-eb-5-program-extension>

beyond those required by H.R. 5992. Despite the protections offered by AT, it is not a substitute for due diligence.

Many regional centers and NCEs retain an independent company to provide more comprehensive services than the AT controls impose. For example, NES Financial provides these types of services to the EB-5 industry. It offers a range of platforms including escrow administration, fund administration and draw down administration.<sup>109</sup> However, it is beyond the scope of this article to compare the services provided by the NES' existing platform with the requirements under AT.<sup>110</sup>

We assume the publicity surrounding the EB-5 reform bills and the adverse publicity surrounding the EB-5 fraud actions has heightened the sensitivity and awareness of investors and migration agents to the importance of conducting thorough due diligence. We hope this motivates them to retain third party professionals to conduct extensive due diligence before the investor finalizes his investment decision, and to continue to monitor the transaction until his capital investment is fully recovered.<sup>111</sup>

We believe AT will have the effect of deterring bad actors who seek to enter the EB-5 space to prey upon unsophisticated, distant investors. These protections should substantially reduce the likelihood of future misappropriation cases, particularly those projects that will become subject to the new AT controls.

## USCIS

### Annual Statement – suggested revisions

This section discusses a provision in H.R. 5992 that is separate from AT controls but, if modified, could work well in tandem with AT as effective tools to combat the misappropriation of EB-5 investor funds, and thereby bolster the integrity of the Program.

The bill includes a section that requires a regional center to annually submit a statement with USCIS.<sup>112</sup> This statement must include, for each NCE associated with a regional center, “an accounting of the aggregate capital invested” in the NCE and JCE by alien investors for each project.<sup>113</sup> We assume this accounting would be presented in the Form I-924A that regional centers must file each year with the USCIS.<sup>114</sup>

Although this might already be contemplated by the existing language in H.R. 5992, we suggest that this requirement be expanded or clarified to include a reconciliation (or comparison) of the total amount of the EB-5 capital raised by the NCE, with the total amount of EB-5 capital in any escrow account, any other NCE accounts, and the amount deployed to the JCE. This would help isolate whether the EB-5 capital raised has flowed to permitted destinations. More specifically, the regional center should be required to reconcile as of the beginning of each year

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<sup>109</sup> <http://nesfinancial.com/solutions/eb-5/>

<sup>110</sup> The authors have not discussed any aspect of AT with NES Financial. However, the authors acknowledge that Reid Thomas of NES has contributed greatly to their general knowledge of EB-5 fund administration and procedures.

<sup>111</sup> For an excellent discussion of recommended points to consider in establishing appropriate loan administration controls and methods to evaluate compliance with these controls, see <http://www.eb5diligence.com/webinars-list/administration-of-eb5-loan>; and also see <http://eb5arnstein.com/eb-5-loan-administration-best-practices/>

<sup>112</sup> Section 203(b)(5)(J) to be added by H.R. 5992.

<sup>113</sup> See Section 203(b)(5)(J)(VI)(aa) to be added by H.R. 5992.

<sup>114</sup> <https://www.uscis.gov/sites/default/files/files/form/i-924a.pdf>

and, as of the end of each year, the amount of alien investment (EB-5) capital raised with the amount held in separate accounts by the NCE (including any escrow) or transferred and deployed to the JCE, less any permissible payments (refunds or recovery of capital) to the alien investors.

Below is a basic example of the reconciliation format to illustrate the point. We recognize that this format would require substantial refinement by USCIS, or development of a different reconciliation format. As part of the Form I-924A, the regional center should be required to explain any difference between the EB-5 capital balance and the total EB-5 capital raised. In addition, when the AT rules become effective, a list of the separate accounts with account balances and other relevant information about the account should be incorporated into the Form. The reconciliation will work well in tandem with AT to promote transparency and provide meaningful information to the EB-5 investors and regulators.<sup>115</sup> Account balance reconciliation with the amount of the capital raised would provide a quick way to verify that the funds maintained and/or deployed by the NCE are in balance with the amount of EB-5 capital raised.

Basic example of EB-5 Capital Reconciliation		
	As of Beginning of Year	As of End of Year
Total EB-5 Capital Raised		
EB-5 capital in NCE escrow		
EB-5 capital held by NCE outside of escrow		
EB-5 capital deployed to JCE		
Total EB-5 Capital		

In addition, rather than wait for EB-5 reform legislation to be enacted, USCIS should consider promptly incorporating some type of reconciliation into its Form I-924A.

We have been informed that many, but not all, regional centers make a copy of the filed Form I-924A available to the EB-5 investors. We believe the Bill should require that a regional center furnish, or at least make available, a copy of this Form to each investor in a NCE. The information provided by the current Form I-924A is not particularly informative, but it will become more meaningful when it incorporates the changes proposed by the Bill. This requirement would promote transparency, and increase the possibility that any misappropriation would be detected earlier by investors who are in better position than USCIS to quickly appreciate the significance of the reported financial information.

We suspect that receipt of this information by USCIS as part of the annual return might not encounter meaningful review until and unless a site visit is conducted or an abuse is reported by others. This requirement, in conjunction with the account balance reconciliation requirement, is likely to serve as a greater deterrent than even an audit, particularly because of its timeliness and the investor's interest in the transaction.

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<sup>115</sup> For simplicity sake, we intentionally omitted any payments or distributions by the JCE to NCE, as well any return on the investment to the investors. These amounts should be taken into account in the reconciliation

## USCIS should take stop-gap action

We are confident that H.R. 5992, or any other new EB-5 reform legislation, will include a provision similar to AT. However, one minor obstacle prevents this provision from becoming law – enactment of EB-5 reform legislation in one form or another. Recent events, particularly since the introduction of S. 1501 in June 2015, illustrate the controversial and contentious nature of the EB-5 reform efforts, as well as the EB-5 Program itself.

If H.R. 5992 or other reform legislation is not swiftly enacted, we urge USCIS to seize the opportunity to establish equivalent rules or regulations that will adopt and implement the concept of account transparency.<sup>116</sup> Although this administrative action might serve as only a stop-gap measure until legislation is enacted, the continued lack of oversight threatens the legitimacy and survival of the Program.<sup>117</sup>

## Conclusion

The Chairmen and Ranking Members of the House and Senate Judiciary Committees should be commended for taking the bold step of seeking to bring transparency to an opaque EB-5 program, and adopting this novel approach to protect EB-5 investors, and more importantly, to protect the integrity of the EB-5 Program.

We intend to update this article when H.R. 5992 is revised, in Committee markup or otherwise, or other similar reform legislation is introduced, to analyze any revisions to the “Account Transparency Requirement.”

**The text of the Account Transparency Requirement extracted from H.R. 5992 appears on the pages immediately following this Conclusion. The page numbers appear at the top of each page and are as set forth in H.R. 5992.**

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<sup>116</sup> USCIS has the authority to promulgate this type of rule or regulation because the transparency requirement reflects a reasonable inference from the existing EB-5 statutory language. This should be contrasted with TEA reform. USCIS probably does not have the power to promulgate regulations that apply New Market Tax Credit type criteria (poverty rate and median family income) to determine TEA eligibility because the existing statute’s sole test for TEA status is the unemployment status of the area where the project is located. If the AT rules would be required to comply with the Administrative Procedures Act, they would face an extended period before becoming effective. <https://www.archives.gov/federal-register/laws/administrative-procedure/> Perhaps, the rules could be implemented as a policy memorandum to expedite the process.

<sup>117</sup> An editorial appeared in the Washington Post on September 29, 2016 advocating the termination of the Program. Unfortunately, the writer attributed false and misleading remarks to Gary Friedland, even though the writer later admitted in an email that he never sought to contact Friedland, and prior to the editorial never communicated with Friedland in any manner whatsoever. The Washington Post declined to publish Friedland’s letter to the editor. See Friedland’s comment – comment #15 - to the editorial. [https://www.washingtonpost.com/opinions/congress-immigration-scheme/2016/09/29/4392dd9e-859a-11e6-92c2-14b64f3d453f\\_story.html?utm\\_term=.0620f41561f5#comments](https://www.washingtonpost.com/opinions/congress-immigration-scheme/2016/09/29/4392dd9e-859a-11e6-92c2-14b64f3d453f_story.html?utm_term=.0620f41561f5#comments)

1 doing that led to an enforcement action de-  
2 scribed in clause (iv)—

3 “(I) the alien shall not be ac-  
4 corded any benefit under this sub-  
5 paragraph; and

6 “(II) the Secretary shall notify  
7 the alien of such belief and, subject to  
8 section 216A(b)(2), shall deny or ini-  
9 tiate proceedings to revoke the ap-  
10 proval of such alien’s petition, applica-  
11 tion, or benefit (and that of any  
12 spouse or child, if applicable) de-  
13 scribed in this paragraph.

14 **“(P) ACCOUNT TRANSPARENCY REQUIRE-**  
15 **MENT.—**

16 “(i) IN GENERAL.—Except as pro-  
17 vided in clause (iii), a new commercial en-  
18 terprise shall deposit and maintain the  
19 capital investment of each alien investor in  
20 a separate account as described in this  
21 subparagraph, including funds held in es-  
22 crow.

23 “(ii) REQUIREMENTS FOR SEPARATE  
24 ACCOUNTS.—

## “(I) REQUIRED INFORMATION.—

1  
2 Prior to, or within one business day  
3 of, the deposit of an alien investor’s  
4 capital investment in a separate ac-  
5 count, the new commercial enterprise  
6 shall provide the following information  
7 to the alien investor whose capital in-  
8 vestment will be or has been deposited  
9 into the separate account, the regional  
10 center associated with the new com-  
11 mercial enterprise, and the Director of  
12 U.S. Citizenship and Immigration  
13 Services:

14 “(aa) The name, address,  
15 and other contact information of  
16 the bank or other financial insti-  
17 tution where the separate ac-  
18 count is or will be maintained  
19 and the name of the authorized  
20 signatory required under sub-  
21 clause (II).

22 “(bb) Sufficient information  
23 to enable the alien investor whose  
24 capital investment will be or has  
25 been deposited into the separate

1 account, the regional center asso-  
2 ciated with the new commercial  
3 enterprise, and the Director to  
4 view online the balance in the  
5 separate account on an ongoing  
6 basis.

7 “(II) AUTHORIZED SIGNATO-  
8 RIES.—At least one of the authorized  
9 signatories to the separate account  
10 shall be an individual who is—

11 “(aa) independent of, and  
12 not directly or indirectly related  
13 to, the new commercial enter-  
14 prise, the regional center associ-  
15 ated with the new commercial en-  
16 terprise, the job creating entity,  
17 or any of the principals or man-  
18 agers of such entities; and

19 “(bb) an officer at the bank  
20 or other financial institution  
21 where the separate account is  
22 maintained; licensed, active, and  
23 in good standing as an attorney,  
24 certified public accountant, or  
25 broker-dealer; or otherwise au-

1                   thorized by the Director to serve  
2                   as a signatory.

3                   “(iii) TRANSFERS FROM A SEPARATE  
4                   ACCOUNT.—

5                   “(I) IN GENERAL.—The funds in  
6                   a separate account may be transferred  
7                   only—

8                   “(aa) to the alien investor  
9                   who contributed the funds held in  
10                  the separate account as a refund  
11                  of that investor’s capital invest-  
12                  ment if otherwise permitted  
13                  under this paragraph, to another  
14                  separate account, or to a job cre-  
15                  ating entity or otherwise deployed  
16                  into the capital investment  
17                  project for which the funds were  
18                  intended; and

19                  “(bb) after at least one of  
20                  the authorized signatories de-  
21                  scribed in clause (ii)(II) has pro-  
22                  vided written consent for the pro-  
23                  posed transfer.

24                  “(II) NOTICE.—Prior to, or with-  
25                  in one business day of, funds being

1 transferred from a separate account,  
2 the new commercial enterprise shall  
3 provide notice to the alien investor  
4 whose capital investment has been or  
5 will be transferred from the separate  
6 account, the regional center associated  
7 with the new commercial enterprise,  
8 and the Director, including—

9 “(aa) the amount of the  
10 funds that are to be or were  
11 transferred; and

12 “(bb) the destination of the  
13 transferred funds, including  
14 whether the funds are trans-  
15 ferred to another separate ac-  
16 count, or transferred directly to a  
17 job creating entity or otherwise  
18 deployed into the capital invest-  
19 ment project for which the funds  
20 were intended.

21 “(III) TRANSFER OF FUNDS.—In  
22 the case of a transfer of funds from a  
23 separate account maintained by a new  
24 commercial enterprise to an affiliated  
25 job creating entity, the affiliated job

1 creating entity shall maintain the  
2 funds in a separate account that  
3 meets the requirements of this section  
4 until the funds are deployed into the  
5 capital investment project for which  
6 they were intended. Within 30 days of  
7 the deployment of the funds into the  
8 capital investment project for which  
9 they were intended, an individual who  
10 is licensed, active, and in good stand-  
11 ing as an attorney, certified public ac-  
12 countant, or broker-dealer, or an indi-  
13 vidual otherwise authorized by the Di-  
14 rector to serve as a signatory, shall  
15 verify that the funds were deployed  
16 into the capital investment project for  
17 which they were intended and shall so  
18 notify the alien investor whose capital  
19 investment was invested, the regional  
20 center associated with the capital in-  
21 vestment project, and the Director.

22 “(iv) ELECTRONIC MAIL AUTHOR-  
23 IZED.—Any notice or information to be  
24 provided under this section may be given  
25 via electronic mail.

1 “(v) DEFINITIONS.—In this subpara-  
2 graph:

3 “(I) The term ‘financial institu-  
4 tion’ has the meaning given such term  
5 by section 20 of title 18, United  
6 States Code.

7 “(II) The term ‘separate account’  
8 means an account—

9 “(aa) maintained in the  
10 United States by a new commer-  
11 cial enterprise at a federally reg-  
12 ulated bank or at another finan-  
13 cial institution in the United  
14 States that is insured; and

15 “(bb) that contains only the  
16 pooled investment funds of alien  
17 investors in a new commercial  
18 enterprise with respect to a sin-  
19 gle capital investment project.”.

20 (c) EFFECTIVE DATES.—

21 (1) IN GENERAL.—Except as provided in para-  
22 graph (2), the amendments made by this section  
23 shall be effective at any time after the date of the  
24 enactment of this Act, as determined by the Sec-

1       retary, and shall be effective not later than 90 days  
2       after such date of enactment.

3           (2) EXCEPTIONS.—

4           (A) Clauses (iv) and (v) of subparagraph  
5       (H) of section 203(b)(5) of the Immigration  
6       and Nationality Act (8 U.S.C. 1153(b)(5)), as  
7       inserted by subsection (b), shall not apply to a  
8       petition that—

9           (i) was filed by an alien investor  
10       under such section 203(b)(5) prior to June  
11       1, 2015;

12          (ii) was filed by an alien investor  
13       under such section 203(b)(5) during the  
14       period beginning on June 1, 2015, and  
15       ending on the date of the enactment of this  
16       Act if such beneficiary is investing in the  
17       same commercial enterprise concerning the  
18       same economic activity as contained in an  
19       exemplar filed prior to June 1, 2015, or  
20       approved by the Secretary of Homeland  
21       Security at any time prior to the date of  
22       enactment of this Act, unless the Secretary  
23       determines that such approval or filing was  
24       based on fraud, misrepresentation in the

1 record of proceeding, or is legally deficient;

2 or

3 (iii) is filed under section 216A of  
4 such Act (8 U.S.C. 1186b) if the under-  
5 lying petition filed under section 203(b)(5)  
6 of such Act was filed prior to June 1,  
7 2015, or approved before the date of the  
8 enactment of this Act.

9 (B) Subparagraph (P) of section 203(b)(5)  
10 of the Immigration and Nationality Act (8  
11 U.S.C. 1153(b)(5)), as inserted by subsection  
12 (b), shall take effect 1 year after the date of the  
13 enactment of this Act and shall apply to any  
14 application filed by a regional center for ap-  
15 proval of an investment under subparagraph (I)  
16 of such section 203(b)(5), as so inserted, filed  
17 on or after such date.

18 **SEC. 4. OTHER EB-5 VISA REFORMS.**

19 (a) **TYPE OF INVESTMENT.**—Section 203(b)(5)(A) of  
20 the Immigration and Nationality Act (8 U.S.C.  
21 1153(b)(5)(A)), is amended—

22 (1) in the matter preceding clause (i), by strik-  
23 ing “(including a limited partnership)”;