



Imagine the Responsibilities

Considerations for Engaging Independent Third Parties to Assist with EB-5 Investment Deployment and Securities Law Compliance

By: Mariza McKee, Kamille Curylo, and Christopher Parrington

Stop and think. Not about job creation, sourcing EB-5 investors, the regulatory future of the EB-5 program, or USCIS adjudication policy, but about your EB-5 transaction team. Your team likely includes the usual EB-5 professionals — an economist, an immigration lawyer, a business plan writer, and a corporate and securities lawyer... but is that enough? Can your regional center handle all other EB-5 transaction responsibilities in house?

Can your regional center provide comfort to investors that EB-5 funds are being properly used for their intended project?

Many regional centers are now engaging qualified independent third parties (“ITPs”) to perform certain functions which help mitigate risk and increase investor confidence in EB-5 transactions. In particular, such regional centers have focused on using ITPs in two distinct areas — (1) using an ITP to help control the flow of EB-5 investor funds from (a) the investor to the new commercial enterprise and (b) from the new commercial enterprise to the job-creating entity (“JCE”); and (2) using an ITP to assist in various aspects of securities law compliance. This article is meant to help regional centers imagine the ways that ITPs may ease their load while simultaneously providing greater EB-5 investor confidence. Furthermore, certain practical tips for engaging an ITP are provided for a regional center’s consideration toward the end of this article.

ITPs and Flow of Funds

With regard to the flow of funds, ITPs can perform several roles to provide EB-5 investors with a base level of comfort that their EB-5 investment will be properly handled and deployed toward the anticipated job-creating activity required to achieve their immigration objectives. Two of the more common roles for ITPs controlling funds flows are (1) escrow agents and (2) deployment agents.

Today, many EB-5 deals are structured with an ITP escrow agent. EB-5 escrow agents typically take direction from the EB-5 new commercial enterprise (“NCE”) representative as to how much money to release to the NCE, based upon negotiated terms set forth in the escrow agreement. EB-5 escrow agents help to provide comfort to investors and their agents by monitoring and safely holding EB-5 investments as the offering is filled with subscribers. The other less common,

and perhaps more critical, use of an ITP, however, is in a deployment agent role, whereby the deployment agent monitors the EB-5 investment deployment into the JCE. In the context of EB-5 investment deployment as a loan to a JCE, an ITP may have responsibility for approving loan draw requests in accordance with predetermined parameters pursuant to a loan agreement. Use of an ITP in this manner helps separate responsibilities and may further comfort investors as to proper use of funds.

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The value of engaging ITPs to usher EB-5 funds from the investor through project deployment is still being fleshed out in the EB-5 industry, and it’s a constant topic of

proposed legislative reform. The American Job Creation and Investment Promotion Reform Act of 2016 (H.R. 5992) includes a proposed account-transparency requirement that would require EB-5 investments to be placed in separate accounts, requiring the signature of an ITP (e.g. bank officer, broker-dealer, attorney, or CPA) prior to the transfer of funds out of the account.

It’s worth noting that, in terms of funds flow, some ITPs go beyond escrow and deployment services to offer fund administration for the full life cycle of EB-5 projects. Some ITPs generate audit trails for both financial and immigration actions, which can prove invaluable for managers that do not have fund administration experience.

Certainly, as time goes on, we will see ITPs acting in roles of increasing responsibility throughout the EB-5 transaction — eventually, the law may require it.

ITPs and Securities Law Compliance

In addition to assisting with the flow of funds, it may be appropriate to enlist ITPs to assist with securities law compliance. Regional centers and NCEs are responsible for ensuring compliance with securities laws, whether purposely or inadvertently triggered by their respective activities. As EB-5 market participants continue to come under scrutiny from the Securities and

Exchange Commission (“SEC”), the Financial Industry Regulatory Authority (“FINRA”), and state securities regulators, engaging ITPs to assist with certain compliance responsibilities may be worth considering. Securities law compliance is a broad term and can seem a daunting task for regional centers that have been operating for several years without a formal securities compliance plan. For illustrative purposes of identifying ITP opportunities, begin by focusing on two foundational blocks — due diligence and anti-money laundering programs.

Performing due diligence is time consuming and can be

expensive for a regional center handling multiple EB-5 projects, especially if it adopts the due diligence procedures required of broker-dealer firms. Not only should a regional center perform a thorough vetting of the issuer/NCE and its offering; it should also prepare significant documentation of its investigation and results. If the regional center is affiliated with the issuer/NCE or is involved in the preparation of the offering materials for the issuer/NCE, a conflict may exist such that the regional center should not compromise its independence as it performs its investigation. Perhaps one of the easiest ways to avoid any potential compromise, and to ensure that due diligence is performed properly, independently and completely, is through the engagement of an ITP due diligence provider. This has been the norm for broker-dealer firms involved in Regulation D offerings for years. Not only are these ITPs well versed in the legal requirements for due diligence, but they have already established the necessary policies and procedures to vet each offering and its issuer.

Regional centers should also consider engaging an ITP with respect to creating and implementing an anti-money laundering (“AML”) program. The Bank Secrecy Act and its implementing regulations require that banks create and implement AML programs designed to prevent money laundering. The USA Patriot

Act expanded the requirement of AML programs to financial institutions that include brokers or dealers in securities, investment banks, loan and finance companies, and certain persons involved in real estate closings and settlements. Although regional centers are not banks subject to the requirements of the Bank Secrecy

Act, and are not typically registered broker-dealer firms, the EB-5 investment model requires the use of banks at many stages. Furthermore, under certain circumstances it would not be unreasonable for a regional center to fit within the definition of a financial institution under the USA Patriot Act. Although

it may not be legally required at this time, regional centers should consider creating and implementing an AML program similar to those required of banks and broker-dealer firms.

The basic requirements of an AML compliance program for broker-dealer firms are set forth in FINRA Rule 3310, and these can serve as guidance for an AML program for regional centers. At a minimum, an AML compliance program should be: approved by a senior manager; reasonably designed to ensure the detection and reporting of suspicious activity; reasonably designed to achieve compliance with the AML rules, including a risk-based customer identification program; independently tested to ensure proper implementation; and designed to provide ongoing training to appropriate personnel. Under applicable AML rules and regulations, a firm is also required to have certain customer identification programs in place to uncover the identity of an investor and ensure that he or she is not acting as a vehicle through which another is laundering money. Given the time commitment and intricacies of creating and implementing an AML program, a regional center may be best served by engaging an ITP AML compliance professional to take on this responsibility, provided that everything is supervised and approved by a senior manager of the regional center.



Engaging ITPs

Regardless of the future of legislative proposals and securities regulator enforcement actions, EB-5 dealmakers would be wise to consider engaging ITPs now. Following are some considerations for a regional center relating to the mechanics of engaging ITPs on an EB-5 financing transaction.

Engagement of an ITP should begin with assessing what responsibilities the ITP will undertake and ensuring the ITP under consideration is well suited for that role. Once the potential role and the targeted market segment for its fulfillment has been identified, a request for proposal (“RFP”) can be prepared to help narrow down the candidates. In terms of garnering and assessing the relevant experience of each candidate, the RFP questions should be both specific (e.g., years of experience, number of deals, dollar size of each deal, and anticipated fees for services) and theoretical (e.g., asking, for example, what sort of legislation might be appropriate to introduce to prevent fraud in the EB-5 industry).

The RFP should explain the range of services that is anticipated from the ITP in the particular role. For example, for an ITP deployment agent, the RFP might include items such as: receiving and reviewing draw requests from the JCE; physically wiring moneys to the various parties; building the EB-5 project on behalf of the JCE; tracking the interest and principal amount that is due from the JCE/borrower for each draw which has been made by the JCE under the loan agreement and executed by the NCE and the ITP deployment agent; applying repayments of the draw requests from the JCE via a monthly waterfall to be described in the loan agreement; and putting together a monthly statement showing the application of such funds received from the JCE to the repayment of the loan.

The precision of the RFP in terms of the range of services needed to fill each ITP role is necessary because it will help determine with greater clarity the true

fees that may be associated with such a role. Fees may also be structured in varying manners depending on the ITP role being filled. For example, an ITP deployment agent might typically consider a one-time, up-front fee plus an annual ongoing fee of a certain number of basis points per annum based on the amount of the EB-5 loan outstanding.

After engaging an ITP, representations and warranties should be negotiated into the engagement and EB-5 transaction documents to clarify its tasks and expectations. For example, in a loan agreement, typically, the ITP deployment agent would want, among other things, to have (a) appropriate indemnification prior to taking actions; (b) clear tasks that it would perform relating back to the range of services provided in the RFP; (c) a standard of care defined (such as prudent person) for its actions; (d) a level of liability set forth for omissions and missteps (e.g., the ITP might agree to be liable in cases of gross negligence or willful misconduct, but not otherwise); (e) forms used to document the monthly or quarterly waterfall distributions of the loan repayments by the JCE; and (f) forms of the draw requests to be utilized by the JCE.

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Conclusion

When selecting your EB-5 financing deal team for your first or next EB-5 transaction, invest a few extra hours to think about the ways that an ITP may be useful in protecting the EB-5 fund flow and ensuring compliance with securities laws. Consider some of the more common methods for managing related-party risk outlined in this article, and use the practical tips provided with regard to structuring an RFP when outsourcing appropriate tasks to ITPs. The use of ITPs in these evolving roles may help you enhance investor confidence and improve the professionalism of your EB-5 endeavor.

Kutak Rock LLP, an NES Financial Medallion Partner, is a national law firm of more than 500 lawyers with offices from coast to coast. Mariza McKee, Kamille Curylo, and Christopher Parrington are attorneys within the firm who specialize in EB-5 finance and compliance.