Suitability and Anti Money Laundering (AML) Concerns for Broker/Dealers Engaged in the Offering and Sale of EB-5 Investments

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In greater frequency, broker-dealers are participating in EB-5 financings. These broker-dealers engage foreign finders and foreign affiliates to locate suitable investors. Engaging foreign finders and foreign affiliates can pose compliance risks which may elevate a firm’s AML risk level and create suitability concerns for the broker-dealer.

In recent literature, FINRA has reminded firms that the scope of permissible business activities and the associated regulatory requirements differ between foreign finders and foreign associates. Specifically, the finders’ activities should not go beyond an initial referral of non-U.S. customers to the firm. NASD Rule 1060(b) permits member firms, in limited circumstances, to pay transaction-related compensation to non-registered foreign persons or foreign finders. According to FINRA, recent examinations have uncovered problematic arrangements where foreign finders were engaged in additional activities including the servicing of customer accounts, entering customer orders, processing new account documents and funds transfers. These activities go beyond the scope of the foreign finder provisions, and the finder is required to be registered as a foreign associate pursuant to NASD Rule 1100 (or in another appropriate registration category) and be supervised as an associated person of the firm. Firms that engage foreign finders must ensure their procedures appropriately address the limited scope of activities permissible under such arrangements and potential risks. See Notices to Members 01-81 and 95-37.

A firm’s AML risk may be further elevated by the use of foreign finders and foreign affiliates to source EB-5 investments depending on the geographical regions involved and types of customers introduced. These are a specific concern in EB-5 transactions because these transactions often include transfers from financial secrecy havens or high-risk geographic locations. Further, EB-5 investments typically include high net-worth individuals, raising the possibility of transacting with politically exposed persons. FINRA advises that prior to entering into foreign finder or foreign associate relationships, firms should have reasonably designed procedures to, among other things, assess and address the potential AML risks associated with the business, and monitor any subsequent activity conducted.

FINRA recently made clear in an Interpretive Letter that when a member broker-dealer offers or sells securities in connection with an EB-5 project, the broker-dealer is subject to FINRA’s suitability rule. The fact that the customers are foreign nationals makes the safeguards provided by the suitability rule no less important. To the contrary, the fact that the investment is being made pursuant to EB-5 adds additional considerations to the firm’s suitability analysis. In determining the “reasonable basis” suitability of the investment, that is, whether the investment is suitable for at least some investors, the broker-dealer needs to consider the legitimacy and viability of the enterprise, and whether the private placement will satisfy the requirements of the EB-5 program. In addition, in considering the suitability of the investment for specific customers, the broker-dealer may take into consideration the fact that at least part of the customer’s motivation for making the investment is to seek U.S. residency.