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March 2016: A Compilation of SEC Enforcement and Non-Enforcement Actions

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Securities & SEC
All Federal

Non-Enforcement

The EB-5 Immigrant Investor Program has Provided a Breeding Ground for Securities Fraud

Back in 1990, Congress created the United States Citizenship and Immigration Services (USCIS) EB-5 Immigrant Investor Program. The idea was to help stimulate the country's economy by encouraging foreign investment in U.S.-based projects in exchange for a quicker path to U.S. citizenship for those foreign investors. The foreign investors, who invested in an EB-5 project of at least $500,000 that would lead to the creation or preservation of 10 or more jobs for U.S. workers, could qualify for an EB-5 visa. Later in 1992, USCIS set aside EB-5 visas for those foreign investor investments made through regional centers designated by the USCIS.

In recent enforcement actions, the SEC took action against six lawyers and three law firms for acting as non-registered brokers in connection with EB-5 offerings.

Typically, such investments are made through the purchase of limited partnership or limited liability company interests formed for the sole purpose of developing the particular investment project. The offer and sale of such interests are "securities" as defined under the state and federal securities laws, but are offered under a private offering exemption such as Regulation D under the Securities Act of 1933. Accordingly, there is no oversight by the U.S. Securities and Exchange Commission (SEC) or state securities regulators in connection with the conduct of the offering, including the offering materials used by promotors of investment projects offered to foreign investors in an EB-5 offering. Securities regulators such as the SEC, however, still have the authority to investigate such offerings for securities fraud and unregistered broker violations.

Stephen L. Cohen, associate director of the SEC's Division of Enforcement, in recent testimony before the U.S. Senate's Committee on the Judiciary, reported on the rising number of SEC enforcement cases involving EB-5 offerings. According to Associate Director Cohen, over the last two-year period ending in December, 2015, the SEC filed 19 cases involving EB-5 offerings. Over half of those cases involved securities fraud allegations. Eleven of those cases involved unregistered broker allegations. There is no question that the SEC has stepped up its review of EB-5 offerings, as many of the offerings are conducted by non-registered persons who often provide little or no disclosure to prospective foreign investors about the risks in connection with such investments.

In order to more effectively regulate such non-registered offerings, the SEC according to Associate Director Cohen, has stepped up its efforts to educate prospective investors about the risks of such investment programs. In addition, the SEC has worked with the USCIS to help prevent and detect violations of the securities laws in connection with EB-5 investment programs.

Investment Advisers and Funds Must Remain Vigilant to Prevent Insider Trading Violations

The SEC continues to actively investigate individuals it believes traded on material nonpublic information purloined from an "insider." As a result, investment advisers and investment funds must stay vigilant and act to ensure that material nonpublic information is not misused by their officers and employees. Failure to stay vigilant will result in time, financial, and emotional costs that are best avoided.

Investment advisers and investment funds should review their compliance policies to make clear that relationships with friends, consultants, outside experts, or business contacts are not to be used to obtain insider information, and to provide appropriate training to employees who routinely work with consultants or other outside experts. Officers and employees need to understand that insider trading laws apply to individuals who trade based on nonpublic information received from insiders, and they need to understand that the penalties for violating insider trading laws can include civil injunctions, disgorgement of profits, monetary penalties, and fines and imprisonment.

The SEC civil case against the general partner of a venture capital firm provides a good example of the risks involved with insider trading. The general partner had a friend whose wife worked for a company that was in discussions to acquire a publicly traded company (the Target Company). The SEC claimed that the wife shared with her husband information about the ongoing merger developments related to the Target Company, and, in turn, the husband shared this information with the general partner of the venture capital firm.

Specifically, the SEC alleged that the general partner purchased approximately $2.5 million worth of Target Company stock and out-of-the-money options in several accounts leading up to the merger announcement. When the two companies announced the acquisition of the Target Company for $35 per share, a price more than 42 percent higher than the Target Company's closing price of $24.56 immediately prior to the announcement, the general partner liquidated his holdings. This allegedly generated more than $1.1 million in illegal profits.

These actions resulted in a civil complaint by the SEC and the arrest of the general partner on charges of criminal securities fraud, and caused reputational damage to the venture capital firm. Investment advisers and investment funds with strong insider trading compliance programs have the best chance of avoiding these negative outcomes for themselves, their officers, and employees. At the very least, evidence of a strong compliance program should prevent such firms from facing liability for breaches of insider trading by their officers and employees.

Enforcement

Investment Adviser's State Licensing Bar Results in SEC Industry Bar

Based upon an order issued by the New Hampshire Bureau of Securities barring a state investment adviser and his firm from being licensed in New Hampshire, the SEC, in a recent action (see In the Matter of *Nicholas Rowe*, IA Release No. 4332, February 9, 2016), barred the adviser and his firm from the securities industry.

While it is not unusual for a state securities regulator to take enforcement action against a person for wrong doing as cited by the SEC in an enforcement action, in this case, the SEC followed the lead of the state regulator by taking enforcement action for the same wrong doing that was the focus of the state enforcement action.

In the New Hampshire enforcement case the staff alleged that the owner and his investment advisory firm engaged in an investment strategy involving leveraged and inverse exchange traded funds (ETFs) that were unsuitable for clients, and misrepresented to clients the amount of fees to be charged and the advisory firm owner's qualifications. Based on the staff allegations, the New Hampshire securities regulator barred the owner and his advisory firm from being licensed under the state securities law, revoked the firm's investment adviser license, and was ordered to pay a $20,000 fine.

Drawing from the New Hampshire enforcement action, the SEC basically "piggy backed" on the New Hampshire allegations to bar the advisory owner from association with any broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent, or materially recognized statistical organization.