The Investment Company Act of 1940 and Underwriting the Financial Gap Between Filing and Approval of the I-526 Petition

*By Steven Anapoell**

Currently, many special purpose entities that are formed to loan project companies capital under the EB-5 Program (commonly referred to as the "loan approach" by EB-5 practitioners) are seeking interim financing to bridge the gap between the filing and approval of their investors' I -526 Petitions by the United States Citizenship and Immigration Service. Unfortunately, certain lenders have been unwilling to provide bridge capital to these special purpose entities ("Lending Conduits") because of a failure by these Lending Conduits to comply with the Investment Company Act of 1940, as amended (the "ICA"), and the lender and/or its financial intermediary are unwilling to assume that risk.

For example, in one such case, the Lending Conduit was in the process of raising funds in excess of $50 million for the benefit of a specific project company (i.e., the job creating enterprise). Recognizing that the registration exemption afforded by Section 3(c)(1) of the ICA was not available (the exemption is only available if there are no more than 100 investors), the intermediary arranging the loan inquired what exemption the Lending Conduit was relying on to avoid registration with the Securities and Exchange Commission (SEC) under the ICA. The Lending Conduit responded that it had consulted legal counsel and was advised that the ICA did not apply to special purpose vehicles (i.e., the Lending Conduit) whose sole purpose is to raise money to loan to a related project company for a single real estate development purpose. The Lending Conduit would hold no assets other than the loan instrument.

Personally, I wish that the Lending Conduit were correct. It would make my job easier and my clients ecstatic that they do not have to structure their deals to comply with an exemption or exclusion from the ICA (and possible compliance with the Investment Advisers Act of 1940 or similar state laws, a discussion of which is beyond the scope of this article). However, based on my review of the ICA and personal conversations with the SEC's Division of Investment Management, the SEC takes the position that loan instruments between Lending Conduits and the project company borrowers are investment securities for ICA purposes. Further, the SEC has addressed the use of special purpose financing conduits and has concluded that they are investment companies that require an exemption from the ICA to avoid registration with the SEC. Specifically, the SEC adopted Rule 3a-5 to enable holding companies that wanted to raise capital through special purpose entities (known as "financing subsidiaries") to provide needed capital to the holding company and/or its subsidiaries to avoid registration with the SEC. Rule 3a-5 provides an exemption from registration under the ICA for both the holding company and its special purpose financing entity if certain criteria are satisfied. Unfortunately, to avail itself of this exemption, the special purpose entity may not grant its investors any voting rights – which are, as we all know, a fundamental requirement of the EB-5 Program. Specifically, to qualify for the EB-5 Program, investors must be provided

certain voting rights, the absence of which will result in a denial of the I-526 Petition.

Accordingly, special purpose entities (e.g., limited partnerships or limited liability companies) formed to raise capital from EB-5 investors to then loan or invest those proceeds in another entity (whether related on unrelated) must register with the SEC under the ICA, unless there is an available exemption or another structure to avoid being characterized as an investment company under the ICA; or seek a no action letter from the SEC that it will not undertake an enforcement action against the special purpose entity for failure to register under the ICA.

Currently, we are discussing with clients the possibility of seeking such a no action letter. The voting rights granted under the EB-5 Program are minimal and we are hopeful that the SEC will understand that the only reason such voting rights exist are to comply with the EB-5 Program, and for no other purpose -- in essence, complying with the spirit and intent of Rule 3a-5. However, the SEC has the final word which may be provided through a no action letter, an enforcement action or, as hoped by many existing regional centers and existing special purpose entities that have raised more than $50 million through a single entity (or multiple entities that can avoid integration as applied by the SEC), by no action act all.

On September 10, 2012, *The Daily* ran an article in which it reported that an immigration official, speaking with anonymity, reported that the "SEC has requested 'some 500 files' related to the program." The article then quotes the official as stating that the "goal is sanctions and penalties" and further adding that "the SEC requested the documents as USCIS attorneys were conducting their own review of whether the EB-5 program had been following securities regulations." The official also reported that "attorneys discovered 'a pattern of not following the rules' . . . '[t]his is huge; this shuts down everybody.'" Given the SEC's heightened attention to the EB-5 Program, I suggest that existing and future Lending Conduits fit within an available exemption to the ICA when structuring a capital raise under the EB-5 Program.

The views expressed in this publication are those of the author and not necessarily those of Greenberg Traurig LLP. The comments contained herein do not constitute legal opinions and should not be regarded as a substitute for legal advice.

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