

EB 5 Securities Compliance for Investors

A comprehensive guide from EB5 Attorneys

Every EB 5 regional center investment is a securities transaction. The limited partnership interests and LLC membership interests that investors purchase meet the definition of "investment contracts" under federal securities law. This means that EB 5 offerings must comply with the Securities Act of 1933, the Securities Exchange Act of 1934, and applicable state securities statutes. Investors who understand these requirements can evaluate offerings more effectively and protect themselves against fraud.

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Why EB 5 Investments Are Securities

The U.S. Supreme Court established the test for determining whether a transaction constitutes an "investment contract" (and therefore a security) in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). Under the Howey test, a transaction is a security if it involves: (1) an investment of money, (2) in a common enterprise, (3) with an expectation of profits, (4) derived from the efforts of others.

EB 5 regional center investments satisfy all four elements. The investor commits \$800,000 or \$1,050,000 to a new commercial enterprise (investment of money in a common enterprise). The investor expects a return of capital and, in many cases, some financial return (expectation of profits). The project sponsor manages the project and creates the jobs (profits derived from the efforts of others). The investor's role is passive.

Direct EB 5 investments present a closer question, because the investor may be actively involved in managing the business. If the investor has meaningful control over the business operations, the investment may not meet the "efforts of others" element. However, many direct investments are structured so that the investor has limited day to day involvement, particularly after initial setup, and may still qualify as securities depending on the facts.

The SEC has explicitly taken the position that EB 5 offerings are securities and has brought enforcement actions against EB 5 project sponsors who violated securities laws. The SEC's Investor Bulletin on EB 5 investments (published 2013, updated 2015) warns investors that EB 5 offerings are subject to the same laws and regulations that govern all securities offerings.

SEC Registration Exemptions: Regulation D and Regulation S

The Securities Act of 1933 requires that all securities offerings be registered with the SEC unless an exemption applies. Registration is expensive and time consuming, so virtually all EB 5 offerings rely on exemptions rather than registering.

Regulation D (17 CFR sections 230.501 through 230.508) is the most commonly used exemption for EB 5 offerings to U.S. based investors. Within Regulation D, Rules 506(b) and 506(c) are the primary provisions.

Rule 506(b) allows an issuer to raise an unlimited amount of capital from an unlimited number of accredited investors, plus up to 35 non accredited investors who meet certain sophistication requirements. General solicitation (public advertising) is prohibited under 506(b). The issuer must provide detailed disclosure to non accredited investors, typically through a Private Placement Memorandum.

Rule 506(c) permits general solicitation but requires that all investors be accredited and that the issuer take "reasonable steps" to verify accredited investor status. Verification methods include reviewing tax returns, bank statements, or obtaining a written confirmation from a registered broker dealer, CPA, or attorney.

Regulation S (17 CFR sections 230.901 through 230.905) governs offerings made to investors outside the United States. Many EB 5 investors are foreign nationals who are not yet present in the United States when they subscribe to a project. Regulation S provides an exemption from registration for offshore transactions, subject to specific conditions including restrictions on resale of the securities into the United States during a distribution compliance period.

Some EB 5 offerings rely on both Regulation D and Regulation S simultaneously, with Regulation D governing U.S. based subscriptions and Regulation S governing offshore subscriptions. The legal structure must ensure that both exemptions are properly maintained, as losing an exemption can expose the issuer to significant liability.

Private Placement Memorandums: What Investors Should Know

A Private Placement Memorandum (PPM) is the primary disclosure document for EB 5 offerings. The PPM serves a similar function to a prospectus in a registered offering: it discloses the material terms, risks, and details of the investment so that investors can make informed decisions.

A well prepared PPM should include: a description of the new commercial enterprise and the job creating entity, the amount of investment required and the terms of the offering, a detailed description of the use of proceeds (how investor capital will be spent), the business plan and economic analysis supporting job creation, the management team's background and qualifications, material risk factors, the terms of any loans from the NCE to the JCE, fee disclosures (administrative fees, management fees, fund administration fees), conflicts of interest affecting the sponsor or its affiliates, and the exit strategy for returning investor capital after the EB 5 immigration purpose is fulfilled.

Read the risk factors section carefully. This section discloses the ways in which you could lose your investment or fail to achieve immigration benefits. While some risk disclosures are generic, a quality PPM will include project specific risks relevant to the particular investment.

The PPM is not a guarantee. It is a disclosure document. Its value lies in the information it provides, not in any promise of outcome. If the PPM omits material information, or if statements in the PPM are false or misleading, the investor may have a cause of action under the anti fraud provisions of the securities laws. Your EB 5 attorney and, if appropriate, a securities attorney should review the PPM before you subscribe.

Accredited vs. Non Accredited Investor Status

Securities regulations distinguish between accredited and non accredited investors because the law assumes that accredited investors have the financial resources and sophistication to bear the risk of private investments.

Under SEC Rule 501 (17 CFR section 230.501(a)), an individual qualifies as an accredited investor if they have: a net worth exceeding \$1,000,000 (excluding the value of their primary residence), individually or with a spouse or spousal equivalent; or annual income exceeding \$200,000 individually (or \$300,000 jointly with a spouse or spousal equivalent) in each of the two most recent years, with a reasonable expectation of reaching the same level in the current year; or certain professional certifications designated by the SEC (Series 7, Series 65, or Series 82 licenses).

Most EB 5 investors qualify as accredited investors because the minimum investment of \$800,000 typically requires substantial wealth. However, not all do, and some investors who meet the investment threshold may not independently qualify as accredited.

If an EB 5 offering is conducted under Rule 506(b), up to 35 non accredited investors may participate, but the issuer must provide them with the same level of disclosure that a registered offering would require. If the offering is under Rule 506(c), all investors must be accredited and the issuer must verify that status through specified methods.

Your accredited investor status may need to be verified through documentation such as tax returns, bank statements, brokerage statements, or a letter from a qualified professional. The PPM and subscription agreement will specify the verification requirements. If you do not qualify as accredited and the offering requires accredited status, you cannot legally participate.

State Blue Sky Laws and Their Application to EB 5

In addition to federal securities laws, every state has its own securities regulation statute, commonly called "blue sky laws." These laws predate the federal Securities Act and provide an additional layer of investor protection at the state level.

For EB 5 offerings relying on Rule 506(b) or 506(c), federal law preempts state registration requirements under the National Securities Markets Improvement Act of 1996 (NSMIA). This means states cannot require the offering to be registered at the state level. However, states retain the authority to require notice filings, collect fees, and enforce their own anti fraud statutes.

Most states require issuers to file a Form D notice (or state equivalent) and pay a filing fee before selling securities to residents of that state. Failure to make the required notice filing can result in state enforcement action, even if the offering is properly exempt under federal law.

State anti fraud provisions operate independently of federal law and may impose different standards. Some states have broader anti fraud statutes that provide investors with additional remedies beyond what federal law offers.

For EB 5 investors, state blue sky law compliance matters for two reasons. First, if the project sponsor has not complied with state notice filing requirements, this may signal broader compliance deficiencies. Second, if fraud occurs, state law may provide an additional avenue for recovery. Your EB 5 attorney should confirm that the offering has complied with applicable state notice filing requirements in every state where investors reside.

SEC Enforcement Actions Against EB 5 Projects

The SEC has brought numerous enforcement actions against EB 5 project sponsors, highlighting the types of fraud and misconduct that investors should watch for. These cases provide concrete examples of what can go wrong.

In *SEC v. A Chicago Convention Center, LLC* (2013), the SEC alleged that a project sponsor raised over \$145 million from more than 250 EB 5 investors for a hotel and convention center project in Chicago that was never built. The SEC alleged that the sponsor misappropriated investor funds for personal use, made false statements about the project's status, and commingled investor capital with personal accounts. The SEC obtained a preliminary injunction freezing assets and ultimately secured disgorgement and penalties.

In *SEC v. Luca International Group* (2016), the SEC alleged that a project sponsor raised approximately \$68 million from EB 5 investors for a renewable fuel project and misused investor funds. The case resulted in a federal receiver being appointed to recover assets for investors.

In *SEC v. US Immigration Fund* (2020), the SEC alleged that the sponsor raised over \$600 million from EB 5 investors and diverted at least \$125 million to insiders and affiliates without adequate disclosure. The case resulted in injunctive relief and ongoing litigation.

These cases share common patterns: the sponsor made material misrepresentations or omissions in offering documents, investor funds were misappropriated or diverted from their stated purpose, conflicts of interest were not disclosed, and independent oversight mechanisms (like fund administration and auditing) were absent or inadequate. The RIA's enhanced compliance requirements, including mandatory fund administration and annual audits, were designed specifically to address these patterns.

The Line Between Immigration Counsel and Securities Counsel

EB 5 cases sit at the intersection of immigration law and securities law. Your immigration attorney handles the I 526E petition, source of funds documentation, and USCIS communications. A securities attorney evaluates the offering documents, assesses compliance with SEC regulations, and advises on the investment's legal structure.

Some EB 5 attorneys have dual expertise and can address both immigration and securities questions. Others focus exclusively on the immigration side and recommend that investors consult a separate securities attorney for an independent review of the offering. Neither approach is inherently better; what matters is that both domains receive qualified attention.

Questions that fall within your immigration attorney's domain include: whether the project structure meets USCIS requirements for the I 526E, whether the business plan and economic analysis support the required job creation, how to document your source of funds, and what filing strategy to pursue.

Questions that fall within securities counsel's domain include: whether the offering is properly exempt from SEC registration, whether the PPM contains adequate and accurate disclosures, whether the subscription agreement terms are fair and consistent with industry standards, whether the sponsor has complied with state blue sky law notice filing requirements, and whether conflicts of interest have been properly disclosed.

If your EB 5 attorney advises you not to consult a securities attorney, or dismisses securities compliance as unimportant, that is a concern. The history of SEC enforcement actions in the EB 5 space demonstrates that securities compliance is material to investor protection. A well structured EB 5 filing addresses both immigration and securities requirements, and competent counsel ensures both are covered.

Practical Steps for Investors: Evaluating Securities Compliance

Before committing capital to any EB 5 project, take the following steps to assess securities compliance.

Request and review the PPM. Every legitimate EB 5 offering should have a PPM. If the project does not have one, or if the sponsor is reluctant to provide it, do not invest. Read the risk factors, use of proceeds, and conflict of interest sections with particular attention.

Verify the exemption. Ask the sponsor or their securities counsel which SEC registration exemption the offering relies on (Rule 506(b), 506(c), Regulation S, or a combination). Confirm that you meet the investor qualification requirements for that exemption.

Check for Form D filings. Issuers relying on Regulation D must file a Form D with the SEC. You can search the SEC's EDGAR database for Form D filings by the issuer's name. The Form D discloses the amount being raised, the exemption claimed, and the names of the executive officers and promoters. If no Form D has been filed, ask the sponsor why.

Review state notice filings. Ask the sponsor whether they have made the required blue sky notice filings in your state of residence. If they have not, ask for an explanation.

Inquire about fund administration. Under the RIA, regional center projects must use independent fund administrators. Ask for the name of the fund administrator and confirm they are independent of the sponsor.

Consider retaining independent securities counsel. If the investment amount is significant (and \$800,000 or more qualifies), the cost of a securities attorney review is a reasonable expense relative to the capital at risk. Your immigration attorney may be able to recommend qualified securities counsel.

Frequently Asked Questions

1. Are EB 5 investments really securities?

Yes. The SEC has consistently treated EB 5 regional center investments as securities under the Howey test (SEC v. W.J. Howey Co., 328 U.S. 293 (1946)). Investors commit capital to a common enterprise, expect returns, and rely on the efforts of the project sponsor. This means EB 5 offerings must comply with the Securities Act of 1933, the Exchange Act of 1934, and applicable state securities laws.

2. What is a Private Placement Memorandum (PPM)?

A PPM is the primary disclosure document for a private securities offering. In the EB 5 context, the PPM describes the project, the investment terms, the use of proceeds, the management team, risk factors, and conflicts of interest. Investors should read the PPM carefully before subscribing. If an EB 5 project does not provide a PPM, that is a serious red flag.

3. Do I need to be an accredited investor for EB 5?

It depends on the offering structure. Under Rule 506(c), all investors must be accredited. Under Rule 506(b), up to 35 non accredited investors may participate with additional disclosure requirements. An accredited investor is generally someone with a net worth over \$1,000,000 (excluding primary residence) or income over \$200,000 individually (\$300,000 jointly) in each of the last two years (SEC Rule 501, 17 CFR section 230.501(a)).

4. How can I check if an EB 5 project has filed with the SEC?

Search the SEC's EDGAR database (sec.gov/cgi-bin/browse-edgar) for Form D filings by the issuer's name. The Form D discloses the exemption claimed, the amount being raised, and the identities of executive officers. Absence of a Form D does not necessarily mean fraud, but it raises questions about regulatory compliance that you should discuss with your attorney.

5. Should my EB 5 attorney also review securities compliance?

Some EB 5 attorneys have securities law expertise and can evaluate both immigration and securities aspects. Others focus on immigration and recommend a separate securities attorney for an independent PPM and offering review. Either approach works, but both immigration and securities domains must receive qualified attention. If your attorney dismisses securities compliance as irrelevant, consider seeking a second opinion.

6. What are state blue sky laws and do they apply to EB 5?

Blue sky laws are state level securities regulations. While federal preemption under NSMIA prevents states from requiring registration of Rule 506 offerings, states retain authority to require notice filings, collect fees, and enforce anti fraud statutes. Your EB 5 project sponsor should have made notice filings in every state where investors reside. State anti fraud provisions may provide additional investor remedies beyond federal law.

Disclaimer: This guide is provided for general informational purposes only and does not constitute legal advice. Every immigration case is unique. Consult a qualified immigration attorney for advice specific to your circumstances.

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