Regulatory Compliance Watch

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Lawsuit challenges accredited investor rules

Supporters of a legal action designed to declare the **SEC**'s accredited investor definition void argue the absurdity of the rules can be seen through their plaintiff, **Emily Kapszukiewicz**.

She serves as CEO of her own company, **Owl Therapy**. The title allows her to be an accredited investor for her firm and, in her role, to entice other financially sophisticated people to invest via the firm's Reg D offerings. Yet, the Commission's accredited investor rules prevent her from putting up to $35,000 into a venture capital fund that she wishes to contribute to.

You likely recall that the Commission's ***accredited investors rules*** require investors to have a net worth exceeding $1 million (excluding their primary residence) and an annual income of at least $200,000 ($300,000 jointly with a spouse) (***RCW***, Dec. 7, 2023).

Just missing the mark

Kapszukiewicz is described as a "successful healthcare professional" possessing a net worth of about $850,000 and taking home an annual salary of about $195,000.

"She has demonstrated financial sophistication through creating price elasticity models, conducting enterprise-level financial analyses, and developing economic frameworks that measure customer lifetime value in healthcare settings. However, she is not an 'accredited investor' according to SEC regulations," reads the ***lawsuit*** filed in federal court in Texas.

Kapszukiewicz "exemplifies what's wrong with the investment restrictions," contends **Nicolas Morgan** of the **Investor Choice Advocates Network** in Los Angeles, and one of her attorneys.

Recent actions in Congress and at the SEC suggest Washington may be primed to revisit the decades old accredited investor rules to help raise capital and promote economic expansion (***RCW***, Aug. 22, 2025 and ***RCW***, March 21, 2025). The lawsuit, if successful, could push along these efforts.

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Content

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"I do feel there is growing bipartisan support [in Congress] to find" better metrics "than wealth and income" to solve the accredited investor issue, maintains Morgan. "This doesn't seem to be a partisan issue."

Greater risks for retail investors?

"Is there more risk of fraud or loss in private markets …. It's possible the answer is 'yes,'" concedes Morgan. But who should get "to decide, who gets to make that decision on risk tolerance?" asks Morgan. He argues his client is better positioned to make that choice than the government.

In their lawsuit, attorneys for Kapszukiewicz argue Congress hasn't given the SEC the authority to restrict investor choice and the current rules violate the Constitution and the *Administrative Procedure Act*.

Private fund managers would welcome an infusion of cash from retail investors judged sophisticated enough to weigh the risks of investing in their funds. The current restrictions caused by the accredited investor definition harm the unregistered venture capital fund, **Healthcare Shares**, that Kapszukiewicz seeks to invest in, her attorneys contend.

"Healthcare Shares Fund is a venture capital firm … created to invest in social impact healthcare startups," according to the non-profit legal group **ICAN**. The fund seeks to benefit society and generate returns for investors but to "achieve their mission, they certainly need capital," ICAN continues.

A larger social purpose

Even SEC ***commissioners*** have argued for the democratization of private investing. ICAN concurs. "With the accredited investor rule, the government is dividing the public into two classes: the wealthy, who get access to opportunity, and everyone else, who are told they don't measure up," it writes.

The Commission's accredited investor rules trample "the basic right to pursue economic opportunity," ICAN continues.

"It doesn't make sense that I can run a company but not invest in one," said Kapszukiewicz. "I've dedicated my career to social impact, entrepreneurship, and healthcare."

Fewer public opportunities

ICAN shared statistics asserting that the numbers of IPOs have reduced markedly over the years while "the greatest growth often occurs in private markets …. The result is predictable: more wealth is accumulated by those who are already wealthy, while ordinary investors are seeing smaller returns on their investments. And when small businesses and entrepreneurs can't access capital from the people who believe in them most, innovation stalls."

Successfully challenging the current rules would "not only restore opportunity to investors—it will unlock capital for small businesses, fuel life-changing innovation, and prove that America's markets work best when they are open to everyone, not just the wealthy few," ICAN concludes. ■

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Another attempt to end SEC 'gag' rule

The line goes something like, "if at first you don't succeed …." Groups that oppose the **SEC**'s so-called "gag" rule that prevents those who settle enforcement actions from later claiming innocence are taking their fight to the last step short of the **U.S. Supreme Court**.

The **New Civil Liberties Alliance** in Washington has been a thorn in the "administrative state" for years, challenging what it sees as out of control regulators exercising unconstitutional power.

The NCLA has tried in the past to get courts to rule the gag rule is unconstitutional but it has lost at each stage (***RCW***, June 24, 2021). Now it's asking the entire **9th Circuit U.S. Court of Appeals** to weigh its latest challenge and it has recruited several prominent allies.

Taking on a 53-year-old rule

"The Gag Rule forbids every American who settles a regulatory enforcement case with SEC from even truthfully criticizing their cases in public for the rest of their lives," states the NCLA in referring technically to SEC Rule 202.5(e), which the Commission adopted in 1972.

Several amicus briefs filed with the court add star power to the effort:

> "[T]he First Amendment prohibits the SEC from railroading settling parties into forever abandoning the right to publicly doubt the Commission's allegations against them," submitted the **Foundation for Individual Rights and Expression**.
>
> "There is no legitimate public interest in suppressing otherwise protected speech simply because it criticizes or embarrasses the government," chimed in the **Hamilton Lincoln Law Institute**.
>
> "If Congress wished for the SEC to issue speech restrictions, it would have done so clearly," contributed the **Cato Institute**.

The Commission's authority to issue Rule 202.5(e) stems from the Securities Act.

Harming all

The **Freedom of the Press Foundation** claimed all Americans can be harmed by the gag rule. It's bad enough that "settling parties [are] strong-armed, by the threat of adverse government action, into forever giving up the right to publicly cast doubt on the Commission's allegations against them, but the press and the public are deprived of key insights from those parties about how the Commission exercises its vast authority," stated the foundation. "The SEC unconstitutionally uses threats of official retaliation to cow targets of its enforcement actions into silence."

The latest court decision

The NCLA's and allies' latest attempt to defeat the gag rule follows on an August decision by the 9th Circuit Appeals Court that sided with the gag rule. Judge **Daniel Bress** ***wrote*** the rule "could impermissibly intrude on First Amendment rights, especially if it prevents civil enforcement defendants from criticizing the SEC."

But he noted the petitioners had failed to provide any "defined records" showing the SEC has reopened a case after a violation of the rule.

The gag rule "has been in place for over five decades, much of that time seemingly without great fanfare," continued Bress. "[D]efendants voluntarily accede to [the speech restriction] in return for substantial benefits," such as reduced penalties or charges.

"The SEC explains that if it is to forego its decision to present evidence in court, the agency should have the opportunity to pursue that path if a defendant later decides to deny the SEC's allegations publicly," Bress wrote in capsulizing the Commission's stance.

Pros and cons

"The absence of a policy like Rule 202.5(e) could lead the SEC to requiring more outright admissions or settling fewer cases, which may not necessarily be in the interest of civil enforcement defendants," Bress stated. "At the same time, the SEC's interests are not so compelling that they would justify a broad restriction on speech, either."

The 9th circuit hasn't yet decided to accept the case *en banc*, meaning with a panel of all of the appeal court's judges. ■

International regulator cooperation seen in case

It's nice when countries play nice. Take the U.S. and Australia.

Regulators from the two countries took separate actions that touched on an **SEC**-registered investment adviser

with global ties. The case suggests the reach of financial regulators around the world, and how one enforcement action can spring others.

Violating the custody rule

In June, the SEC won its case against **Brite Advisors**, charging that the now-unregistered adviser had consistently violated the ***custody rule***. The Commission asserted that the adviser for years failed to obtain "an annual internal control report – an important safeguard that verifies client assets – from an independent public accountant registered with the" **PCAOB**.

The adviser's worldwide ties illustrate how regulators must adapt to the international nature of finance. Most of its harmed clients were British expats living in the U.S., who had earned pensions back home. Their money would fall into an omnibus account custodied in Australia.

It may well have been regulators from Down Under who prompted the SEC to take a closer look at the New York-based adviser. In 2019, Brite recommended to new and old clients to move their money to an affiliated custodian, **Brite Australia**.

Four years later, Australian regulators got a court order freezing Brite Australia's assets because that firm had failed for years to produce "an audited balance sheet."

One case washes another

Another source that may have drawn the SEC's attention to the New York adviser stemmed from an earlier enforcement action brought in 2018 against two salesmen, **Benjamin Alderson** and **Bradley Hamilton**. The Commission charged them with misleading hundreds of clients and prospective clients about the benefits of the pension transfers while concealing "serious" conflicts of interest, including the substantial compensation that they received (***RCW***, June 8, 2018). The transfers involved pensioners from Britain.

In Brite's action, regulators were troubled by how Brite Australia used a margins' feature on funds in the omnibus accounts. Regulators argued the funds were used to benefit Brite USA "and not to benefit the clients whose assets have been put at risk." The Commission charged that the adviser "had a fiduciary duty to disclose the risks and conflicts of interest" to their clients.

Misleading disclosure

Instead, Brite USA received $19 million from Brite Australia "to pay its operational expenses," according to court records. "Brite USA failed to make further inquiries of the Brite Group Parent or Brite Australia regarding the margin feature and made inaccurate and misleading disclosures to its clients," the Commission states.

The SEC found that Brite's advisory agreements and Form ADV failed to disclose the "exit fees" that Brite Australia would charge clients. The Commission faulted the firm for omitting this "important information that Brite Australia would fund any such advances of 'exit fees' by incurring a margin loan balance on the Original Omnibus Account that encumbered all client assets, regardless of whether the client received an advance."

Later, Brite Australia created a separate omnibus account exclusively for the clients of the U.S.-based adviser. But the SEC held that "this arrangement" did not eliminate the risks faced by its clients.

New disclosures did not fully reveal the extent to which "margin debt on the Original Omnibus Account had already funded Brite USA's operations or the extent of borrowing against the Original Omnibus Account, did not describe the extent to which Brite USA relied upon the Brite Group Parent and Brite Australia for ongoing financial support, and did not explain the related conflicts of interest."

The Australian Commission received its sought-after court order freezing the affiliated company's assets in 2023. The SEC brought its action that same year.

The challenge of the custody rule

The SEC case "goes to the very heart of its provenance

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as an important anti-fraud protection," **Christopher Gilkerson**, principal of **Gilkerson Law** and president of **RiAdvantage Consulting**, tells ***RCW***.

"The defendant investment advisor recommended to clients that they switch their accounts to a proprietary 'platform,' which in fact was run by an overseas financial affiliate who then placed the assets with a broker-dealer in an omnibus account controlled by the affiliate in order to take out margin loans collateralized by the client assets to fund operations. All without disclosing the risks or conflicts of interests to clients."

This resulted in the overseas entity having custody, "thereby requiring an internal control report by an independent public accountant to ensure the safety of client assets," continues Gilkerson. Had Brite Advisors "followed the rule, the internal control report surely would have uncovered the numerous breaches endangering client assets. For its transgressions, the defendant agreed to the 'death penalty' and ceased" operations.

A final lesson learned

"Although this case had unique cross-border facts, one cautionary tangle of this tale is that when an RIA is part of a larger financial conglomerate owned by others, client assets cannot be treated as corporate assets to be moved around and controlled for the benefit of the owners instead of managed in the best of interest of clients," concludes Gilkerson. ■

MFA lays out 401(k) principles

Federal regulators should support Americans' 401(k) plans by opening them to alternative investments through target-date and other asset allocation funds with "strategy-neutral" policies that focus on more than just the size of fees and also protect pension fiduciaries from "overzealous litigation," the **Managed Funds Association** says in a new white paper.

"Traditional balanced portfolios that include only publicly traded stocks and bonds no longer represent the broader economy and investment universe," the MFA says in ***laying out*** its five principles for democratizing America's $10 trillion private pension market. "ERISA does not dictate what investments are permitted to be made by any employee benefit plan. It authorizes the fiduciaries of the plan, not the government, to make that determination, acting prudently and in the best interests of plan participants. Most fiduciaries hire professional financial and legal advisors to help them select investment options."

The work the association is cheering on has already begun. In August, President **Donald Trump** signed an executive order. It directs the **SEC** and the **Department of Labor** to review its rules and guidelines to come up with ways to harmonize the private and public markets (***RCW***, Aug. 18, 2025).

Outsized role

For now, the work is stalled by the government shutdown.

But the MFA will play an outsized role in whatever the Trump administration comes up with. It has powerful allies throughout the administration, allies made in part because of the aggressive stance the association took against the **Biden** administration.

The MFA's new white paper, ***released*** late last month, lays out five principles it wants Department of Labor regulators to focus on when they return to their rulemaking work.

- **Principle 1:** "Plan beneficiaries are best served with a flexible and wide range of investment options, including exposure to alternative investment strategies through target date or other asset allocation funds, to help meet participants' retirement savings needs," the MFA says. Retirement customers, the group says, "should be entitled to participate in alternative investment strategies, with appropriate safeguards and oversight by plan fiduciaries."

- **Principle 2:** "Regulatory clarification on alternative investment strategies should be investment strategy neutral," the group says. Any new rules or guidelines should be "process-based to best support the ability of plan sponsors to implement a plan menu with a range of strategies appropriate to their participants – not requiring plan sponsors to select or exclude specific asset classes."

- **Principle 3:** Pension fiduciaries are an important safeguard, the MFA says. "Alternative investments make the most sense for 401(k) investors when a sophisticated investment professional is evaluating the investment, such as a professionally managed account, an asset class or strategy within a larger diversified fund, or a target date or asset allocation fund managed by a registered investment adviser," the group says.

- **Principle 4:** "Fees should be evaluated based on the nature and breadth of the investment services being provided and the character of each plan and its participants," the group says. "ERISA does not require

that a plan pay the lowest fee possible. Policymakers should continue to emphasize and reinforce that while fees and expenses must be reasonable, they must always be evaluated in light of the actual services being provided and the returns to investors after fees. Reasonableness should be determined based on the marketplace for such services. The ability of an asset allocation fund to meet its long-term investment objectives net of fees should be one of the criteria taken into consideration in assessing investment strategies for inclusion in the portfolio."

- **Principle 5:** "Overzealous litigation must be addressed," the MFA says. "Fiduciaries of 401(k) plans have been subject to numerous class action lawsuits, which seek to leverage ERISA's rules to make defending cases expensive. Such actions provide limited benefit to the participants, but create legal risk for plan sponsors. Policy makers should prioritize actions that may curb ERISA litigation that constrains fiduciaries' ability to apply their best judgment in offering investment opportunities to plan participants." ■

GOP launches democratization bill

House Republicans have introduced legislation that would make permanent President **Donald Trump**'s democratization policies.

In August, Trump ***signed*** an executive order directing the **SEC** and the **Department of Labor** to find ways of offering retail investors access to alternative assets, including private equity, hedge funds and crypto (***RCW***, Aug. 18. 2025). The one-page, nine-line *Retirement Investment Choice Act*, introduced Oct. 14 ***says*** that the president's order "shall have the force of law."

It's sponsored by Montana Rep. **Troy Downing** and five of his Republican colleagues: **Byron Donalds** (Florida), **Warren Davidson** (Ohio), **Marlin Stutzman** (Indiana), **Buddy Carter** (Georgia) and **Barry Moore** (Alabama).

"Alternative investments hold the transformative potential to supercharge the financial security of countless Americans saving for retirement," Downing said in an email statement announcing the legislation.

Symbolic gesture

For now, the measure is merely symbolic: Washington remains shuttered as Democrats fight to restore healthcare subsidies wiped out by Trump's "Big, Beautiful Bill" (***RCW***, July 14, 2025).

Nonetheless, private funds and their allies can be cheered that at least something is getting done on democratization. The shutdown, now rounding the corner on its third week, has stripped the SEC and Labor to its gears (***RCW***, Oct. 9, 2025).

Meanwhile, even if the government flies back into its work, significant obstacles remain. Private funds may offer high returns, but they also come with higher fees. And the $9 trillion 401(k) market is "the most litigious" in wealth management, **Franklin Templeton** President and CEO **Jenny Johnson** ***told*** ***RCW*** affiliate title Private Equity International. ■

Healthcare merger reviews expanded

California Gov. **Gavin Newsom** has signed a fresh bill widening the Golden State's review of private fund-backed healthcare mergers and acquisitions.

AB 1415 widens the lens of California's **Office of Healthcare Affordability** to include private equity and hedge fund managers, as well as managed service organizations. Newsom signed the measure Oct. 10.

Under California law, healthcare companies must provide written notice to OHCA for any material change transaction. The office cannot stop a merger, but it can slow it down considerably by ordering a cost-and-market-impact review.

Beginning next year, "noticing entities"—including private equity or hedge fund managers behind proposed healthcare transactions—must submit written notice for OHCA's review.

Small change, big impact

On its face AB 1415 is not a big change.

"While PE groups, hedge funds, and MSOs have indirectly been subject to OHCA's review by virtue of their involvement in covered transactions, OHCA does not currently impose independent filing requirements on these entities (as they are not considered "health care entities" subject to review)," lawyers at **Ropes & Gray** ***wrote*** when the law passed California's legislature.

AB 1415's implications are much bigger, though. For starters, California is one of the world's largest economies. Its healthcare spending reached nearly $409 billion in 2023, or almost $11,000 per person, state regulators ***say***.

They're back

AB 1415 also should tell private funds and their allies that the issue of private funds-in-healthcare is not going away.

At this time last year, Newsom vetoed a bill similar to AB 1415. It capped a frenetic year for private fund managers and their allies, who found themselves fighting rear-guard action against state policy- and lawmakers over the role of private funds in healthcare (***RCW***, Oct. 7, 2024).

Then President Donald **Trump** won the national elections. State legislatures haven't gotten active again. A few days before he signed AB 1415, Newsom signed a bill that expanded California's already existing corporate-practice-of-medicine laws to give the attorney general authority to sue private equity or hedge fund managers who interfere with medical decisions in the doctors' and dentists' practices in which they invest. It also voids non-compete and some non-disclosure clauses in employment agreements (***RCW***, Oct. 9, 2025). ■

The risk in ignoring automated trading alerts

Velocity Clearing's Compliance Department attracts some unwanted heat in a new **FINRA** enforcement action concerning identifying potentially manipulative trading by the broker-dealer's customers. In a Sept. 30 ***settlement***, the SRO reveals that while the firm's WSPs delegated responsibility for reviewing manipulative trading surveillance alerts to compliance, the department's review of the alerts "was not reasonable." The result: a $1 million penalty.

Cross-market surveillance conducted by FINRA flagged the compliance failure. The SRO found that from December 2019 through the present, Velocity's WSPs required the firm to monitor customer trading activity for the use of "any fraudulent device, scheme, or course of business in connection with the purchase or sale of securities."

Deficient WSPs

However, the WSPs were determined to be deficient for several reasons, including:

- They did not provide any guidance as to what factors to consider when assessing surveillance alerts or explanations offered by traders or customers for the trading activity under review.
- They did not address whether the aggregate activity or the number of surveillance alerts generated by a particular customer was relevant to the firm's review.
- The WSPs did not detail how to document the review and the disposition of an alert.
- The WSPs did not provide guidance on when and how to escalate an alert for a firm principal to conduct a secondary review.

Closing of alerts

FINRA noted in the settlement that from December 2019 through June 2023, Velocity employed an automatic surveillance system to identify the likes of spoofing, layering, cross trades, wash trading and prearranged trading. The problem: While the surveillance system generated 150,000 alerts, over 147,000 of the alerts were closed by compliance "without conducting any investigation into the trading of the customers' potential patterns of trading over time."

Remarkably, one-third of the surveillance alerts were closed on the same day they were opened, said FINRA. "Compliance Department staff often closed hundreds or thousands of surveillance alerts on a single day," the SRO added.

Resources problematic

Insufficient resources proved a key culprit. Initially, review responsibility fell to a single employee "who also spent a significant amount of time on other responsibilities." A subsequent hiring of five additional individuals still wasn't sufficient. "The volume of alerts, lack of adequate staffing, and lack of training or guidance prevented the firm's Compliance personnel from conducting reasonable reviews and follow-up investigations," concluded FINRA.

Persistent issues

Issues continued. FINRA noted that a new automated surveillance system implemented in July 2023 has generated 15.2 million trading alerts. "The firm closed nearly all such alerts without any investigation or action," said the SRO. "As of early 2025, over 5.2 million alerts identifying potentially manipulative trading remained unreviewed," it added.

In addition to paying the fine, Velocity agreed to the retention of an independent compliance consultant. In the settlement, the firm neither admitted nor denied FINRA's findings. ■

Crypto disclosure not 'fair and balanced'

Chalk up another **FINRA** enforcement action tied to the SRO's targeted cryptocurrency exam sweep. The San Francisco-based firm **Stockpile Investments** will pay a $50,000 penalty for distributing retail communications that didn't clearly disclose that crypto assets were not offered through a registered broker-dealer, and which didn't provide a "fair and balanced" presentation of their benefits and risks.

In the exam sweep that originated in November 2022, FINRA examiners sought a list identifying each crypto-related communication provided along with firms' WSPs for reviewing, approving and keeping these communications, among other items (***RCW***, Nov. 23, 2022). The SRO also asked for the provision of "any compliance policies, manuals, training materials, compliance bulletins, and any other written guidance in effect for any portion of the relevant period concerning communications."

Unaffiliated entity offering

Similar to a prior case involving **Firstrade Securities** (***RCW***, June 5, 2025), the new enforcement action against Stockpile covers from July to September 2022. FINRA found that Stockpile distributed communications regarding crypto assets and crypto asset-related services offered by an unaffiliated entity that violated one or more of the content standards in rule 2210. The communications included a webpage, email, and the firm's mobile application interface and related promotional materials, the SRO noted in the settlement.

"Most of the communications failed to prominently disclose that the crypto assets were not offered by Stockpile Investments, but were offered by an unaffiliated entity which, unlike Stockpile Investments, was not a registered broker-dealer or member of FINRA or SIPC," stated FINRA.

Cited language

The SRO cited a Stockpile email to prospects announcing the launch of the firm's mobile application that contained the statement "Stockpile is the only place where kids can choose from over 30 cryptocurrencies or redeem Stockpile gift cards from both crypto and stock." FINRA charged the statement "failed to distinguish between the products and services offered by the firm and those offered by the unaffiliated entity."

The SRO added that some of Stockpile's violative communications "discussed crypto assets offered through the unaffiliated entity without a balanced description of both the benefits and the associated risks of investing in those assets." In agreeing to the settlement, Stockpile neither admitted nor denied FINRA's findings.

SEC exam letter

Regulators are very focused on crypto. ***RCW***'s *Compliance Toolbox* contains an **SEC *exam letter*** received by an advisory firm that invests in cryptocurrency. The six-page letter addresses 35 items, including the adviser's standard advisory contract; a list of all proprietary and third-party models available to clients; a list of all digital assets held in client portfolios; any code of ethics; changes to P&Ps; a current inventory of compliance risks; and evidence of the most recent annual compliance review. ■