



BUSINESS DAILY COVER

The Government Is Quietly Suing Its Way To Broader Powers Over Traders

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In reshaping 89 years of rules governing who's required to register their business with the government, the SEC is using the courts to wage a campaign to vastly widen its regulatory reach.

No one would ever mistake [Ibrahim Almagarby](#) for a Wall Street power player. No one except, perhaps, the U.S. government.

Almagarby's story is a cautionary tale for anyone who trades securities in the U.S. It's an example of a federal agency, in this case the SEC, deciding to change how it enforces its rules on who needs to register as a dealer but telling no one, then pursuing and winning a lawsuit against an entrepreneur for not figuring out, somehow, that the game was suddenly different. The new interpretation wasn't only a personal disaster for Almagarby, whose punishment was forfeiture of over three years of profits and a ban on penny-stock trading. It would also give the SEC such vast oversight that it could end up making trading a lot more difficult for just about anyone in the country.

In 2013, Almagarby was a 20-something student living in Tamarac, Florida, when he started a business called Microcap Equity Group. It had no clients, just Almagarby buying what's called convertible debt from penny-stock companies, converting it to stock — hence the name — and selling it.

Over the next three-and-a-half years, Almagarby conducted [38 transactions](#) for a profit of [\\$1.5 million](#), according to court documents that detail his trading. Not exactly ocean-view-penthouse money, but apparently a pile high enough to draw the attention of the SEC.

No doubt, convertible debt is controversial. It's legal, but you probably wouldn't see a Mother

Teresa making this trade. Because it feeds the bittersweet narcotic of high-interest loans to desperate companies, it's been called "death-spiral financing," and its conversion to stock often causes the company's share prices to tumble.

But the unsavory nature of the trade wasn't the government's objection when the SEC came calling. The agency sued Almagarby and Microcap Equity Group in November 2017 for "acting as unregistered securities dealers." To hear securities lawyers and other experts tell it, this was unprecedented. Since 1934, when the definition for "dealer" was written into law, nobody who traded only for their own account, like Almagarby did, was required to register as one.

It's plausible that the SEC played a strategic hand, selecting Almagarby as its opening salvo in a campaign to extend its tendrils into every last financial crevice. The agency chose a convertible-securities trader who was not only less than sympathetic because of how he makes his money, but because, by Wall Street standards, he's small fry. Each of Almagarby's transactions averaged a modest \$30,000 or so — hardly the kind of clout that can sustain a long legal battle with the U.S. government.

So there were few headlines in August 2020 when the U.S. District Court for the Southern District of Florida [agreed](#) with the SEC that Almagarby — and Microcap Equity — had run afoul of the

agency's rules by not registering as a dealer. The court said that his trading frequency "had made him more than an active investor" and agreed with the government that a trader with a business model based entirely on purchases and sales of securities had to go through the hassle of registration and the increased scrutiny of being a dealer. That includes background checks, compliance checklists, escalated record-keeping costs and capital requirements.

"For 90 years, it's been well understood that a dealer is one who takes the other side of a customer's trade using their own account," Brian Richman, an attorney at Gibson, Dunn & Crutcher who represents a defendant in a similar case, told *Forbes*. "What the SEC says now is forget about all of that. It says if you're a business and buy and sell for your own account and do it regularly, you're a dealer. That sweeping interpretation has never been advanced by the SEC or anybody else over the past several decades."

A Sword of Damocles now hangs over trading firms, home offices, crypto accounts and any individual whose work time is primarily spent buying and selling securities. Critics fear the legal precedent will cast a threatening shadow over trading in Treasuries and could even be used to nudge some of the [1.5 million Americans](#) who day-trade to register with the regulator.

Whether the SEC will expand its enforcement beyond convertible-debt traders remains a mystery. The agency isn't saying, and it declined to talk to *Forbes* for this story. One thing we do know: the government is charging ahead. It's got nearly a dozen cases, and more to come, similar to Almagarby's that are working their way through the courts, with one penalty potentially topping [\\$10 million](#) and another that could exceed [\\$100 million](#).

There's already been fallout. The same court in Florida that in 2020 went against Almagarby [ruled against](#) another trader, Justin Keener, founder of lender JMJ Financial, for the same reason in December. Keener was ordered to pay \$10.2 million in disgorgement of profits and penalties and will have to refrain from buying and selling penny stocks for five years. Key point: Keener was also trading convertible debt.

"What the SEC is doing here is unfair to real people in the real world," Keener told *Forbes* in an email forwarded by his lawyer. "After the 2008 financial crisis, the SEC encouraged people like me to loan money to small businesses in the form of convertible notes. The SEC even reviewed and approved registration statements for many of my trades. But now, the SEC is trying to change the law on these transactions, not on a forward-looking basis through Congress, but backwards-looking through the courts, and against the people

the SEC [encouraged](#) to provide capital to small businesses in the first place.”

Regulators have overlooked “death-spiral financing” in the past when it came to requiring traders to register as dealers. In 2014, Auctus Fund Management, a defendant in a case similar to Almagarby and Keener’s, provided FINRA, the industry’s trading supervisor, with a sample contract for its convertible-debt agreements, according to documents seen by *Forbes*. FINRA didn’t question whether Auctus should have been registered as a dealer at that time, according to a person familiar with the matter.

The SEC has apparently changed its mind, and the decision was hailed by advocates of convertible-debt borrowers. [Brenda Hamilton](#), a Boca Raton, Florida-based securities attorney who has represented companies shocked into reality by the devastating impact convertible debt can have on their share prices, says the agency’s maneuvering is nothing more than an effort to attach a leash to those she regards as shady operators.

“We’ve seen people turn \$100,000 on a note into a million in a short period of time,” Hamilton told *Forbes*. “If they were making lower amounts, I don’t think the SEC would be expending the resources on this.”

UCLA law professor James Park concurred. “I’m not entirely sure that these cases will mean that a

wide range of funds will have to register as dealers,” Park told *Forbes* in an email. “These rulings can be limited to the particular context of these cases.”

Whether the SEC is targeting only unsavory traders or not, there are other ways to redefine the role of dealers, said Gabriel Gillett, a partner at Jenner & Block.

“If the problem is the definition of a dealer, ask Congress to change it,” Gillett, the author of an [amicus brief](#) in support of Keener, told *Forbes*.

Instead, the SEC has instituted a “we’ll-know-it-when-we-see-it” criterion for what constitutes a dealer. One amicus brief in support of Almagarby highlights the absurdity, saying the SEC “claims to have discovered in a long-extant statute an unheralded regulatory power.”

In March 2022, more than four years after it sued Almagarby, the SEC finally got around to [saying](#) publicly that it was interested in broadening the definition of dealer. In its announcement, the commission appeared to demolish the argument that it was only moving against convertible-debt traders. Rather, the new interpretation would include just about anyone making a dime in almost any market.

The idea stirred up a hornet’s nest of resistance across financial circles. Venture Capital fund a16z [cautioned](#) in a comment letter that the rule could

dry up appetite for digital assets, amplify volatility and put the brakes on “digital asset infrastructure” progress. Market-maker Virtu Financial [chided](#) the regulator for overreaching without justification. Republican lawmakers joined the choir. Senator Bill Hagerty of Tennessee and Congressman French Hill of Arkansas asserted that the proposal could [drain](#) the lifeblood from the vital U.S. Treasury market.

Critics suggest the regulator is pulling a fast one, bypassing the usual red tape and getting new procedures approved through the courts instead. Should the SEC keep scoring victories, it could, by establishing precedents, effectively create a new legal order.

“Major changes such as this must involve Congress and should involve the public,” Suzan Rose of the [Alternative Investment Management Association](#) trade group, told *Forbes*. “Right now we’re looking at cases where they’re going after people with such a small threshold. I don’t see how it couldn’t grab everyone.”

Both Almagarby and Keener are appealing the decisions against them.

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