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ORGANIZED CRIME ON WALL STREET

HEARING

BEFORE THE

SUBCOMMITTEE ON
FINANCE AND HAZARDOUS MATERIALS

OF THE

COMMITTEE ON COMMERCE
HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

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ORGANIZED CRIME ON WALL STREET

WEDNESDAY, SEPTEMBER 13, 2000

HOUSE OF REPRESENTATIVES,
COMMITTEE ON COMMERCE,
SUBCOMMITTEE ON FINANCE AND HAZARDOUS MATERIALS,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2322, Rayburn House Office Building, Hon. Michael G. Oxley (chairman) presiding.

Members present: Representatives Oxley, Largent, Shimkus, Fossella, Ehrlich, Bliley (ex officio), Barrett, Luther, and Markey.

Staff present: Brian McCullough, majority professional staff; Robert Simison, legislative clerk; and Consuela Washington, minority counsel.

Mr. OXLEY. The subcommittee will come to order.

Good morning. Today's hearing might sound like an episode of The Sopranos, but it is not HBO. It is real. We are going to hear the true stories about people getting bilked out of their hard-earned money by the Mob. I know from my own experience as a special agent in the FBI that the Mob will go wherever a dollar is being made. Today that is Wall Street. So it is really not surprising that organized crime is trying to suck some of the life out of the blossoming securities markets. The M-O-B has gone back to school and gotten an MBA. The wiseguys are getting smart. They used to play ponies. Now they are playing the markets and investors for everything they are worth.

When I was in the FBI investigating the organized crime in Boston, the Mob was in shipping, racketeering, garbage, loan sharking and good old-fashioned shakedowns. Now they are moving from the old economy to the new, but using the same old tactics of intimidation, extortion and manipulation.

As reported by Greg B. Smith of the New York Daily News, one anonymous regulator discussed what he called the maggot run, meaning the Mob-connected brokers moving from one firm to another, attempting to stay just ahead of the law. By the way, I would recommend Mr. Smith's article of this past Sunday to anyone interested in reading more about the topic. This happens to be the front page of the article "The Mob on Wall Street: Inside the Mafia Stock Fraud Scams." And I think it says a lot about what we are going to be discussing today; the lure of quick profits in the securities markets that has turned businessmen into criminals and criminals into businessmen.

It is our job to work with the organizations testifying before us today to ensure that the U.S. capital markets are clean and fair

and remain the envy of the world. It is disturbing to know that there is an organized, concerted effort by criminals to enter and control one of the most successful sectors of our economy for the sole purpose of defrauding investors. We know about the "pump it and dump it" schemes that leave investors with worthless stock. We are aware of boiler rooms falsely promoting penny stocks of both legitimate and dummy companies. What is new is organized crime.

I want to send my congratulations to the Federal and State authorities that netted 120 arrests in June for the biggest stock scam in U.S. History. Something tells me a lot of those Sopranos will be singing for the government as prosecutors bring their cases to court. We have the best markets in the world in part because we have the best and fairest regulatory system in the world. That continues to give investors confidence in capital markets that are increasingly the road to a comfortable retirement, the place to put your education nest egg. The markets are also a powerhouse of capital for companies to expand and create jobs. There is no coincidence that our economic growth overlaps the boom of new investors in the market.

We are here today to examine how prevalent organized crime is in our markets and hear about efforts to stop the fraud. Our witnesses today are experts and can speak about battling securities crime on the front line. I welcome Mr. Fuentes of the FBI, Mr. Walker of the SEC, Mr. Skolnik representing the State Securities Administrators, and Mr. Goldsmith of NASDR. We thank you for your time and look forward to your testimony.

I now want to—let me first indicate that our ranking member Mr. Towns is en route and hopes to get here for the hearing. He had a primary yesterday in the Empire State, and he may be a little bit tired from his victory in that primary, and so we look forward to having him with us at a later time.

Now, let me turn to our friend from Illinois, the gentleman Mr. Shimkus, for an opening statement.

Mr. SHIMKUS. Thank you, Mr. Chairman. I will be brief. I want to thank the panel for coming.

I think we, as citizens of this great Nation having the great exchanges, great financial exchanges, the success only stems from faith and trust in the individual consumers. And so this, from what we have learned on the boiler rooms issue and its focus in schemes on senior citizens, it shakes the foundation of the faith and trust in the markets. That is why this hearing is so important. I appreciate your time.

And with that, Mr. Chairman, I yield back my time.

Mr. OXLEY. I thank the gentleman from Illinois.

[Additional statements submitted for the record follows:]

PREPARED STATEMENT OF HON. TOM BLILEY, CHAIRMAN, COMMITTEE ON COMMERCE

Thank you Mr. Chairman.

There has been an increase in organized criminal activity on Wall Street over the last few years. The modus operandi appears to be to set up a sham company, threaten brokers to hype the stocks, and when the paper value of the company inflates, dump the stock, leaving legitimate investors with nothing of value.

This should come as no surprise—where there is money to be made, you will find organized crime. Being aware of such corruption should increase our vigilance.

Organized crime on Wall Street threatens virtually every American—because it damages the integrity of our capital markets, the life blood of our economy. By infiltrating our markets, corrupt forces pose a very real threat to the prosperity this country is currently enjoying.

The FBI and the SEC, as well as state regulators, are doing fine work to preserve market integrity and investor confidence. I thank them for that work and welcome all of our witnesses here today. I am pleased that Chairman Oxley has called this hearing today to increase awareness of organized crime in the financial marketplace and ensure that "cops on the beat" are using the strongest possible measures to fight this scourge.

PREPARED STATEMENT OF HON. JOHN D. DINGELL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Due to the press of other Congressional business and a resulting schedule conflict, I was unable to participate in the hearing on organized crime's involvement in the securities markets. I commend the Subcommittee for holding this hearing and I thank Chairman Oxley for keeping the record open for Members' statements.

As a former prosecutor for Wayne County, I have a strong commitment to the enforcement of our laws and a very healthy respect for the difficult and often thankless jobs carried out by the FBI and the federal and State securities regulators. They deserve this Committee's strong support.

This hearing is overdue. In December 1996, Business Week warned us, in its seminal cover story, "The Mob on Wall Street," that we had a serious problem: "A three-month investigation reveals that organized crime has made shocking inroads into the small-cap stock market." In response, I wrote to the Department of Justice, the Securities and Exchange Commission, and NASD Regulation, asking them what they were doing about this travesty. I am submitting these documents and the article for the hearing record. In sum, Justice said that it could neither confirm nor deny the existence of an investigation. The SEC offered a confidential briefing and subsequently rescinded that offer to protect ongoing investigations. Therefore, I am pleased that we are finally getting some answers. Several of the individuals and entities mentioned in the Business Week article have been the subject of SEC and criminal enforcement actions.

The Subcommittee witnesses testified that the mob-related activity was concentrated in the market for the smallest microcap stocks. In December 1997, I opened up an investigation into rampant fraud in microcap stocks and pressed the regulators to take prompt action to address it. I also am submitting the documents associated with that investigation for the hearing record. I commend the regulators for what they have done and note that dealing with this problem will require constant vigilance by all of us.

On the basis of our combined record and the testimony of the witnesses at the Subcommittee hearing, I have the following concerns:

—A lot of this activity is migrating to the Internet and the Committee has not done enough to make sure that our securities-crime cops have the necessary tools to police the Internet;

—There has been scant progress in stemming the migration of crooked brokers and more needs to be done, such as giving the NASD express authority to provide a broker's disciplinary history to investors over the Internet so that they can more readily identify scoundrels;

—Staff turnover at the SEC Enforcement Division is straining the agency's ability to investigate and litigate these and other cases and I strongly encourage the Committee to pass pending pay parity legislation to help the agency keep its best and brightest on the job protecting the American public;

—A lot of these scams rely on fraudulent financial statements that have been given a clean bill of health by the auditors, suggesting that mob-related companies are exploiting the Private Securities Litigation Reform Act provisions weakening accountants' liability and accountability for securities fraud: this ill-advised loophole needs to be closed.

There is a Latin proverb: Nemo sine crimine vivit. That translates into: No one can live without crime. While it is true that the crooks are always with us, I believe that we can and should work together to make it a whole lot harder for them to operate and fleece our constituents. I pledge to work with my colleagues and the law enforcement authorities to that end.

THE PAYOFF FROM LOW INFLATION / JAPAN: A NEW RECESSION?

BusinessWeek

DECEMBER 16, 1996 A PUBLICATION OF THE McGRAW-HILL COMPANIES $3.50

Two men appeared at the office of the CEO of a small Manhattan brokerage. They took him for a walk. One of the men stuck a gun in his ribs. 'From now on,' he was told, 'you'll be retailing all of our stock.'

THE MOB ON WALL STREET

By Gary Weiss

THE MOB ON WALL STREET

A three-month investigation reveals that organized crime has made shocking inroads into the small-cap stock market

BY GARY WEISS

 ILLUSTRATIONS BY RICHARD MERKIN

In the world of multimedia components, Phoenix-based SC&T International Inc. has carved out a small but significant niche. SC&T's products have won raves in the trade press, but working capital has not always been easy to come by. So in December, 1995, the company brought in Sovereign Equity Management Corp., a Boca Raton (Fla.) brokerage, to manage an initial public offering. "We thought they were a solid second- or third-tier investment bank," says SC&T Chief Executive James L. Copeland.

Cover Story

But there was much about Sovereign that was known to only a very few. There were, for example, the early investors, introduced by Sovereign, who had provided inventory financing for SC&T. Most shared the same post office box in the Bahamas. "I had absolutely no idea of who those people were," says Copeland. He asked Sovereign. "I was told, 'Who gives a s—. It's clean money.'" The early investors cashed out, at the offering price of $5, some 1.575 million shares that they acquired at about $1.33 a share—a gain of some $5.8 million.

By mid-June, SC&T was trading at $8 or better. But for SC&T shareholders who did not sell by then, the stock was an unmitigated disaster. Sovereign, which had handled over 60% of SC&T's trades early in the year, sharply reduced its support of the stock. Without the backing of Sovereign and its 75-odd brokers, SC&T's shares plummeted—to $2 in July, $1 in September, and lately, pennies. The company's capital-raising ability is in tatters. Laments Copeland: "We're in the crapper."

A routine case of a hot stock that went frigid. Or was it? Copeland didn't know it, but there was a man who kept a very close eye on SC&T and is alleged by Wall Street sources to have profited handsomely in the IPO—allegedly by being one of the lucky few who sold shares through a Bahamian shell company. His name is Philip Abramo, and he has been identified in court documents as a ranking member, or *capo*, in the New Jersey-based DeCavalcante organized crime family.

James Copeland didn't know it. Nobody at SC&T could have dreamed it. But the almost unimaginable had come true: Copeland had put his company in the hands of the Mob.

Today, the stock market is confronting a vexing problem that, so far, the industry and regulators have seemed reluctant to face—or even acknowledge. Call it what you will: organized crime, the Mafia, wiseguys. They are the stuff of tabloids and gangster movies. To most investors, they would seem to have as much to do with Wall Street as the other side of the moon.

But in the canyons of lower Manhattan, one can find members of organized crime, their friends and associates. How large a presence? No one—least of all regulators and law enforcement—seems to know. The Street's ranking reputed underworld chieftain, Abramo, is described by sources familiar with his activities as controlling at least four brokerages through front men and exerting influence upon still more firms. Until recently, Abramo had an office in the heart of the financial district, around the corner from the regional office of an organization that might just as well be on Venus as far as the Mob is concerned—the National Association of Securities

Three men appeared at the office of a dealer in small-cap stocks. One of the men carried a gun. The trader was roughed up. His company stopped trading the stock

Dealers, the self-regulatory organization that oversees the small-stock business.

A three-month investigation by BUSINESS WEEK reveals that substantial elements of the small-cap market have been turned into a veritable Mob franchise, under the very noses of regulators and law enforcement. And that is a daunting prospect for every investor who buys small-cap stocks and every small company whose stock trades on the NASDAQ market and over the counter. For the Mob makes money in various ways, ranging from exploiting IPOs to extortion to getting a "piece of the action" from traders and brokerage firms. But its chief means of livelihood is ripping off investors by the time-tested method of driving share prices upward—and dumping them on the public through aggressive cold-calling.

Cover Story

In its inquiry, BUSINESS WEEK reviewed a mountain of documentation and interviewed traders, brokerage executives, investors, regulators, law-enforcement officials, and prosecutors. It also interviewed present and former associates of the Wall Street Mob contingent. Virtually all spoke on condition of anonymity, with several Street sources fearing severe physical harm—even death—if their identities became known. One, a former broker at a Mob-run brokerage, says he discussed entering the federal Witness Protection Program after hearing that his life might be in danger. A short-seller in the Southwest, alarmed by threats, carries a gun.

Traders who run afoul of the Mob often get menacing calls. One short-seller in the Southwest, alarmed by threats, packs his own piece

Among BUSINESS WEEK's findings:

■ The Mob has established a network of stock promoters, securities dealers, and the all-important "boiler rooms"—a crucial part of Mob manipulation schemes—that sell stocks nationwide through hard-sell cold-calling. The brokerages are located mainly in the New York area and in Florida, with the heart of their operations in the vicinity of lower Broad Street in downtown Manhattan.

■ Four organized crime families as well as elements of the Russian Mob directly own or control, through front men, perhaps two dozen brokerage firms that make markets in hundreds of stocks. Other securities dealers and traders are believed to pay extortion money or "tribute" to the Mob as just another cost of doing business on the Street.

■ Traders and brokers have been subjected in recent months to increasing levels of violent "persuasion" and punishment—threats and beatings. Among the firms that have been subject to Mob intimidation, sources say, is the premier market maker in NASDAQ stocks—Herzog, Heine, Geduld Inc.

■ Using offshore accounts in the Bahamas and elsewhere, the Mob has engineered lucrative schemes involving low-priced stock under Regulation S of the securities laws. Organized crime members profit from the runup in such stocks and also from short-selling the stocks on the way down. They also take advantage of the very wide spreads between the bid and ask prices of the stock issues controlled by their confederates.

■ The Mob's activities seem confined almost exclusively to stocks traded in the over-the-counter "bulletin board" and NASDAQ small-cap markets. By contrast, New York Stock Exchange and American Stock Exchange issues and firms apparently have been free of Mob exploitation.

■ Wall Street has become so lucrative for the Mob that it is allegedly a major source of income for high-level members of organized crime—few of whom have ever been publicly identified as having ties to the Street. Abramo, who may well be the most active reputed mobster on the Street, has remained completely out of the public eye—even staying active on the Street after his recent conviction for tax evasion.

■ Mob-related activities on the Street are the subject of inquiries by the FBI and the office of Manhattan District Attorney Robert M. Morgenthau, which is described by one source as having received numerous complaints concerning mobsters on the Street. (Officials at both agencies and the New York Police Dept. did not respond to repeated requests for comment.)

Only small NASDAQ and OTC stocks appear to have been

■ Overall, the response of regulators and law enforcement to Mob penetration of Wall Street has been mixed at best. Market sources say complaints of Mob coercion have often been ignored by law enforcement. Although an NASD spokesman says the agency would vigorously pursue reports of Mob infiltration, two top NASD officials told BUSINESS WEEK that they have no knowledge of Mob penetration of member firms. Asked to discuss such allegations, another high NASD official declined, saying: "I'd rather you not tell me about it."

■ The Hanover, Sterling & Co. penny-stock firm, which left 12,000 investors in the lurch when it went out of business in early 1995, is alleged by people close to the firm to have been under the control of members of the Genovese organized crime family. Sources say other Mob factions engaged in aggressive short-selling of stocks brought public by Hanover.

■ Federal investigators are said to be probing extortion attempts by Mob-linked short-sellers who had been associated with the now-defunct Stratton Oakmont penny-stock firm.

Mob manipulation has affected the markets in a wide range of stocks. Among those identified by BUSINESS WEEK are Affinity Entertainment, Celebrity Entertainment, Beachport Entertainment, Crystal Broadcasting, First Colonial Ventures, Global Spill Management, Hollywood Productions, Innovative Medical Services, International Nursing Services, Novatek International, Osicom Technologies, ReClaim, SC&T, Solv-Ex, and TPT. Officials of the companies deny any knowledge of Mob involvement in the trading of their stocks, and there is no evidence that company managements have been in league with stock manipulators. These stocks were allegedly run up by Mob-linked brokers, who sometimes used force or threats to curtail short-selling in the stocks. When support by allegedly Mob-linked brokerages ended, the stocks often suffered precipitous declines—sometimes abetted, traders say, by Mob-linked short-sellers. The stocks have generally fared poorly (table, page 99).

Not all of the stocks were recent IPOs, and they were often taken public by perfectly legitimate underwriters. International Nursing, for example, went public at $23 in 1994 and was trading at $8 in early 1996 before falling back to pennies. Short-sellers who attempted to sell the shares earlier this year were warned off—in one instance by a Mob member—market sources assert. International Nursing Chairman John Yeros denies knowledge of manipulation of the stock.

What this all adds up to is a shocking tale of criminal infiltration abetted by widespread fear and silence—and official inaction. While firms and brokerage executives who strive to keep far afield of the Mob often complain of NASD inaction, rarely do such people feel strongly enough to share their views with regulators or law enforcement. Instead, they engage in self-defense. One major brokerage, which often executes trades for small-cap market makers, keeps mammoth intelligence files—to steer clear of Mob-run brokers. A major accounting firm keeps an organized-crime expert on the payroll. His duties include preventing his firm from doing business with brokerages linked to organized crime and the Russian Mob.

In the pages that follow are the results of BUSINESS WEEK's investigation.

THE BOX

At about 3 o'clock in the afternoon of Sept. 25, 1996, three men appeared on the 28th floor of 120 Broadway, Manhattan. They walked into the offices of Sharpe Capital Inc., a dealer in over-the-counter stocks. They were burly. "Like lumberjacks," said an eyewitness soon after. A gun was in the belt of one of the men.

The confidential police report of the incident (Complaint No. 10530, First Precinct) reads as follows:

"At that point they asked the victim what he was trading in. Then they slapped him in the head and stated again, 'What the f— are you trading in.' Then he slapped the victim in the head again."

A witness recalls one of the men saying: "Don't f— with our stock." The stock: Crystal Broadcasting Inc. After the men left, Sharpe stopped trading in Crystal Broadcasting.

To the New York Police Dept., the incident at Sharpe was about as serious as a scuffle over a parking space. A police source says that the assault, categorized as a low-grade misdemeanor at best, is considered closed and is not being investigated because the victim was not seriously hurt, no gun was displayed—even though one was observed—and the per-

HOW THE MOB MAKES MONEY ON WALL STREET

TRADING SCAMS

THE BOX Mob-affiliated traders control the market for a stock and its price by trading it among themselves—enforcing their control through bribery, violence, and intimidation. They then unload the stock on the public at an inflated price and, sometimes, sell it short to profit when the shares go bust.

REGULATION S Through offshore accounts, Mob members illegally buy cheap stock issued under Regulation S of the securities laws—supposedly reserved only for foreign investors. The cheap stock is sold on the open market at vast, riskless markups.

FLIPPING Mobsters, through front men, quickly unload, at inflated prices, stocks that are the subject of hot IPOs issued by firms they control.

BROKERAGE SCAMS

HIDDEN OWNERSHIP Through front men who have no criminal records, the Mob controls, or has hidden ownership stakes in, at least two dozen NASDAQ brokerage firms.

TRIBUTE Mob members get kickbacks from brokerages for protecting them from shakedown attempts by other mobsters.

EXTORTION Mobsters, working with short-selling confederates, demand payments in return for not shorting the stocks issued by penny-stock and microcap brokerages.

DATA: BUSINESS WEEK

exploited. Shares are driven up—then dumped on the public

IN THE SHADOWS OF THE SMALL-CAP MARKET

PHIL ABRAMO Abramo is described by sources as controlling at least four brokerage firms and is identified in court documents as a *capo* in the DeCavalcante organized crime family. He recently pleaded guilty to one count of tax evasion, for which he faces one year in prison. He is scheduled to report on Jan 7.

THOMAS QUINN The multinational stock honcho allegedly has ties to Phil Abramo. Quinn was sued by the SEC for securities fraud in 1989 and owes massive civil penalties.

DOMINICK "BLACK DOM" DINASSIO He controls broker Euro-Atlantic, say Street sources. A short-seller told police Dinassio threatened him for trading a Euro-Atlantic stock.

ALPHONSE "ALLIE SHADES" MALANGONE To law enforcement, Malangone is an alleged loan shark, gambler, and longtime power behind Mob control of New York's Fulton Fish Market. To Wall Streeters, he is a sophisticated trader who is an expert at working the spreads—getting in at the bid price and exiting at the ask price.

ALAN LONGO Malangone's right-hand man is described by sources as a heavy gambler who, along with Malangone, maintained control of the now-defunct penny-stock firm of Hanover Sterling through their links to Roy Ageloff.

JOHN "SONNY" FRANZESE Sources say Franzese joined the Mob's rush to the stock market after his 1994 parole from a 50-year term for bank robbery. The 77-year-old kingpin was recently found to have violated the terms of his parole and was ordered back to prison.

ROY AGELOFF Sources say he's the power behind PCM Securities. He allegedly "persuaded" a trader to drop a stock by inviting him to his office, where the trader was beaten.

JOHN GOTTI JR. The reputed New York Mob boss would have profited nicely from an IPO of an Italian ice maker. The canceled offering's shares traded high the first day.

petrators were unknown. (However, one witness ruefully notes, police did nothing to ascertain their identity—such as examine a security-camera surveillance tape.) Sharpe's CEO, Lawrence Hoes, declined to discuss the matter.

But BUSINESS WEEK learned that the assault at Sharpe was not an isolated incident. Rather, it was part of a systematic pattern of intimidation. By eliminating competing market makers and allowing only cooperating brokers to bid on stocks, the result is a kind of rigged auction—with the prices where desired, and the spreads between bid and ask prices kept as wide as possible. In Street parlance, this process of rigging the market in a stock is known as "boxing" a stock. It is part of the lexicon of the Mob's dominion on Wall Street (page 99).

Cover Story

The box is the heart of most stock-manipulation schemes. In the case of Crystal, the trader at Sharpe was suspected of "cracking the spread." According to market sources who were familiar with the trading in Crystal that day, Sharpe was blamed, in effect, for doing what a market maker is supposed to do—get the best possible price for its customers and keeping the spreads as narrow as possible. During the day, Crystal traded as low as 4, well below the 5¾ closing price of the day before, and the spreads narrowed as well, to a relatively reasonable 4⅝ bid and 4¾ ask. Sharpe was blamed for that benign—to most people—market action.

In the weeks following the Sharpe incident, Crystal shares were trading at the kind of spreads that can only happen when the market is tightly controlled. If you buy it from a dealer, you pay the ask price, $3.50. But when you sell it, you get the bid—56.2¢. (Crystal's president, Joseph Newman, said he had no knowledge of coercion of market makers in his stock.)

Sometimes the maneuvering involved in creating and exploiting the box can be as subtle as a bison in a china shop. One West Coast investor, who requested anonymity, says that brokers at a small New York firm, Monitor Investment Group, convinced him that two small-cap stocks—International Nursing Services and Beachport Entertainment—were about to be pushed upward. Says the investor: "They said they had a handle on all this stock. They said they'd run it up and get me out of it in a week."

So sometime around last New Year's Day, he bought warrants and a big block of the stock—100,000 shares of International Nursing and $5,000 of Beachport. When he tried to sell, he says, his brokers flatly refused. The shares, which had started heading southward almost from the moment he bought them, plummeted. They're now worth one-fifth of what he paid. Monitor Chairman William F. Palla denies the firm was involved in stock manipulation but concedes a broker may have promised a runup but not really meant it.

Sometimes, of course, thinly traded stocks can be run down by aggressive short sellers, and the Mob is alleged by Street sources to have profited from that as well. One target of investigators, sources say, is a coterie of brokers formerly associated with the defunct penny-stock brokerage of Stratton Oakmont. Sources familiar with the investigation say that authorities are exploring charges that some of these brokers, after Stratton's demise, may have extorted money from their former colleagues in the business—allegedly threatening to short-sell stocks underwritten by those firms. According to

PHOTOGRAPH BY ANDY UZZLE/NEW YORK POST (JOHN FRANZESE)

sources, the Stratton brokers allegedly shared their profits with a member of a New York crime family.

Among the trading being investigated, sources say, are stocks underwritten by a penny-stock firm called State Street Capital Markets. Stocks brought public by the New York-based firm—Fun Tyme Concepts, U.S. Bridge of N.Y., and Cable & Co. Worldwide—were pummeled in the market last August, and trading in the stocks is allegedly being probed. At the time, State Street maintained that its shares were victimized by concerted short-selling. State Street officials did not return phone calls, and Stratton officials could not be reached for comment.

"YOU'VE MADE A FRIEND"

First Colonial Ventures Ltd. is a minor venture-capital firm whose stock trades on the OTC bulletin board—so small that it is not required to file more than token disclosures with the Securities & Exchange Commission. But for market makers in small-cap stocks, First Colonial looms huge. It is an object lesson: When the Mob speaks, market makers obey.

The incidents took place early in October, one week after the assault at Sharpe. First came a beating. A trader at Naib Trading Corp. in Fort Lauderdale was summoned to the office of a man by the name of Roy Ageloff. The trader has told associates that Ageloff had beaten him once before with a nail-pierced baseball bat. This time, he said, Ageloff left the room. Then a 400-pound hoodlum knocked him down and kicked him while he was on the floor. The message: Stay away from First Colonial.

The trader at Naib was not the only one to suffer "persuasion" over First Colonial. Sources say that four other firms were approached with warnings to cease trading in the stock. To be sure, it was not a total success. There was one rebuff: A market maker in the little town of Hurst, Tex., Anthony Elgindy of Key West Securities Inc., says he ignored warnings that traders who did not comply would soon be "facing the ceiling"—and has received numerous threatening phone calls since then. But at two other market makers, the intimidation worked. They ceased making a market in First Colonial.

The market makers dropping the stock were William V. Frankel & Co. in Jersey City, N.J., and the biggest name in NASDAQ stocks: Herzog, Heine, Geduld. Sources say traders at both firms quit trading the stock after receiving menacing visits at their offices. "We decided we shouldn't get involved in a stock like that," says Herzog's head trader, Irwin Geduld. Was anyone at his firm threatened? "We weren't," said Geduld. "Someone else was." (A Frankel trader, who declined to give his name, says: "We have no comment whatsoever about First Colonial Ventures.") Even a brokerage that was not a market maker, D.L. Cromwell Investments Inc. in Boca Raton, received a visit from a thug, a source says. The visitor left after demanding, and being shown, proof that the firm was not a short-seller in the stock. Cromwell officials declined comment.

Sources say that traders who caved in to coercion later received expensive bottles of liquor with a note that read: "You've made a friend." But the market makers who dropped First Colonial were making no new pals among investors. Since the incident, the ask price paid by the public for buying First Colonial stock has climbed—from a low of $1.13 on Oct. 2 to as high as $4.13 in recent trading. But the bid price that the public gets when selling the stock back to the Street has been far less buoyant. The bid promptly rose from a low of 87¢ on Oct. 2 to $1.50 and has stayed at about that level, even as the ask price has skyrocketed to al-

MOBSPEAK: A GLOSSARY

CHOP STOCK A thinly traded stock with a very wide bid-ask spread

VIG The ultrawide bid-ask spread commonly found in Mob-dominated stocks

HOUSE STOCKS Stocks sold aggressively to the public by the firms that control them

BOXING (AS IN "BOXING A STOCK") Controlling the market for a stock by trades among cooperating brokerages

PARKING Buying a stock for a customer by "mistake," as part of a scheme to hike the price and control the market in a stock

MOB-EXPLOITED STOCKS: MOST HAVE SUFFERED

These stocks have been identified by BUSINESS WEEK. The companies say they know of no Mob stock-rigging.

	52-WEEK HIGH	PRICE 12/3/96
AFFINITY ENTERTAINMENT Produces feature and TV films	10	2 7/32
BEACHPORT ENTERTAINMENT Entertainment production company	6	1 1/2
CELEBRITY ENTERTAINMENT Operates theme park in Florida	3 11/32	3/16
CRYSTAL BROADCASTING Runs and acquires radio stations	6 1/2	3/16
FIRST COLONIAL VENTURES Miscellaneous holdings	8 3/4	3 7/8
GLOBAL SPILL MANAGEMENT Environmental contractor	11 23/32	3/4
HOLLYWOOD PRODUCTIONS Motion picture producer	11 1/2	8
INNOVATIVE MEDICAL SERVICES Makes water-purification system	7 3/4	4
INTERNATIONAL NURSING SERVICES Health-care services	8 1/4	1 1/16
MAMA TISH* Makes Italian ices	N/A	N/A
NOVATEK INTERNATIONAL Makes diagnostic devices	13 1/8	1/2
OSICOM TECHNOLOGIES Fiber-optic products	20 1/2	8 1/2
RECLAIM Builds solid-waste treatment plants	42 1/2	1/8
SC&T Makes multimedia peripherals	9	5/32
SOLV-EX Extracts oil from oil sands	38	13 5/8
TJT Tire repair and reconditioning	9 5/8	5 1/4

*Initial public offer was withdrawn, November, 1996.

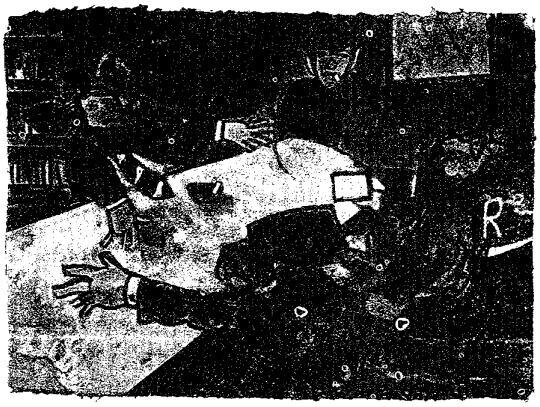
DATA: BLOOMBERG FINANCIAL MARKETS, BUSINESS WEEK

Abramo is "educated, sounds sincere. He's gotten all these wiseguys to work together," says one source

most three times that figure. (On Oct. 4, according to a letter sent to market makers obtained by BUSINESS WEEK, the NASD launched an inquiry into the dropping of First Colonial stock by market makers. The NASD declined comment on the investigation.)

Who was behind the wave of intimidation over First Colonial? NASDAQ trading figures point toward a New York-based firm called PCM Securities Ltd. PCM was the largest market maker in First Colonial in September, with 48% of the trades. By October, however, this rose to 75%. PCM completely dominated the market in First Colonial.

Although he is not listed in NASD records as a control person or even as an employee of PCM—or of any other brokerage—Street sources say that the power behind PCM is the 37-year-old Ageloff. He did not respond to numerous messages left at PCM's office in Boca Raton. An employee there said Ageloff nowadays spends most of his time there, punctuated by frequent visits to New York. Asked about Ageloff, Steven Edelson, PCM's principal, denied that Ageloff has any role in the firm and says he has met him only once. Edelson had no comment on its trading in First Colonial, and First Colonial President Murray Goldenberg said he was "shocked" to hear reports of intimidation of market makers.



Whistle-blowers at Mob-dominated firms are rare, but a former broker at Monitor Investment alleges in a federal lawsuit that he was beaten with a chair at the brokerage

A TALE OF TWO MARKETS

Even though NASD records show Ageloff has not been officially associated with any brokerage firm over the past two years, he is a widely known figure in small-cap stock circles. Why would market makers drop a stock just because Ageloff tells them—even when he is not accompanied by "persuasion"? Street sources say the fear he inspires is justified: The force that drives Ageloff, they maintain, is a 59-year-old man who, on official record at least, has never set foot on Wall Street. He is Alphonse Malangone, otherwise known as "Allie Shades," and his few appearances in the public record pertain almost exclusively to another market—the Fulton Fish Market.

Cover Story

"Allie Shades" Malangone is the Zelig of the Mob's Wall Street coterie. For years, he has been observed by investigators in lower Manhattan, ensconced in the twin worlds of the Fulton Fish Market and the stock market. To law enforcement he is an alleged loan shark and gambler, a longtime power behind Mob control of the Fulton market, and he is described in court proceedings by federal and state law enforcement officials as a *capo* in the Genovese crime family.

But to the very few Wall Streeters who know him, he is a sophisticated market player who is an expert at "working the spreads"—getting in at the bid price and exiting at the ask price, with the help of cooperative traders. "He's very smart, very articulate," says one investigator. "When you hear him on the wire, he would couch what he would say in gambling phrases" to mislead investigators.

Investigators are not fooled, but despite close surveillance and wiretaps dating back to the 1980s and perhaps before, they have been unable to make a case against Malangone and other reputed Fulton market mobsters for their suspected activities on Wall Street. One longtime Malangone-watcher recalls that the Fulton market was believed by law-enforcement authorities in the early '80s to be a clearinghouse for stolen bonds. But nothing was ever proven.

Investigators thought they were on to something, finally,

in 1985. They had in their sights two big fish, so to speak—Malangone and Vincent Romano, also identified in court papers as an alleged Genovese family member who was suspected of involvement in the Fulton market. Malangone and Romano were probed by federal and local authorities for their alleged manipulation of a pharmaceutical company stock, Nu-Med Inc., a company that later declared bankruptcy. Investigators believed that the two men had a position in Nu-Med shares. The investigation was never made public, for authorities couldn't build a case against Malangone and Romano. Efforts to reach the two men were unsuccessful.

Cover Story

Sources on Wall Street say that Malangone was a behind-the-scenes player in the biggest penny-stock fiasco of recent years: Hanover Sterling. According to sources, Malangone controlled Hanover through his right-hand man, Alan Longo, who has been identified by federal authorities in court filings as a member of the Genovese family. Longo, who is described by acquaintances as a heavy gambler, is said by sources to have worked directly with Ageloff in Hanover and other market ventures.

Ageloff—in concert with his alleged Mob contacts—is believed by market sources to have been the hidden control person at Hanover. It went out of business in early 1995 and resulted in the demise of the firm that it cleared through, Adler, Coleman & Co. An attorney for the trustee in the Adler Coleman bankruptcy, Mitchell A. Lowenthal, says that his firm, Cleary, Gottlieb, Steen & Hamilton, has discovered evidence that 65% of Hanover's profits were shared by Ageloff and another Hanover official. Efforts to reach Hanover execs were unsuccessful.

An alleged Mob loan shark and gambler is said to have been a behind-the-scenes player in one of the biggest penny-stock fiascos in recent years: Hanover Sterling

Street sources say that the Mob was involved in both sides of the Hanover-Adler imbroglio. The Malangone-Longo-Ageloff faction, they say, profited from the rumup in Hanover stocks, while other mobsters allegedly sold short the Hanover stocks and pushed their prices downward—to the chagrin of the Malangone faction. This internecine dispute, sources close to Hanover say, was eventually resolved without bloodshed, but only after some tense meetings between Mob factions. Lowenthal says that his firm's investigation has shown that "Ageloff and some of the shorts were all connected [to the Mob] in one way or the other," but nothing was proven.

According to people close to the Hanover Sterling machinations, the Mob was represented on the short side through Falcon Trading Group and Sovereign Equity Management Corp. And those brokerages, sources say, are controlled by the alleged SC&T profiteer—a silver-haired, 51-year-old resident of northern New Jersey named Philip C. Abramo.

Abramo's name has never surfaced in any of the thousands of pages of deposition testimony taken by the adversaries in the Hanover-Adler Coleman legal warfare. Nor have his recent legal troubles—a federal fraud indictment—resulted in exposure of his Street ties or alleged Mob membership. Abramo's stunning success at avoiding publicity has helped make him the most active reputed Mob honcho on Wall Street. "He is educated. He sounds sincere," says one source. "He's gotten all these wiseguys to work together."

THE "CONSULTANT"

In court records and corporate filings, Philip Abramo gives his business address as 176 Saddle River Road, South Hackensack, N.J. The address applies to not one but several buildings, forming a kind of cul de sac on a dreary street in an industrial town in northern New Jersey. It is a quiet area. A cemetery is next door. Faded lettering shows that one of the buildings was once used many years ago to process meat. Today they house an auto-body shop, a construction company, and other little offices with ambiguous names.

Listed in no official records is another address for Phil Abramo—one that is far more apropos for a man who is a hidden power in the brokerage industry. Until a couple of months ago, sources say, Abramo maintained an office on the 14th floor of 90 Broad St. in lower Manhattan, directly adjoining the New York office of Sovereign Equity Management. A door linked the two offices, and it was always open. "I knew him as a stock promoter who always had stock deals. We hired brokers who were friends of his," says one Sovereign employee who requested anonymity. Sovereign CEO Glen T. Vittor denies that Abramo had any role in the firm.

But sources describe his role as central—as the hidden control person behind Sovereign, a prominent name in the micro-cap stock business, its sister firm Falcon Trading, and two other firms that are major penny-stock brokers and market makers, Toluca Pacific Securities Corp. and Greenway Capital Corp. He is also described by Street sources as controlling other dealers in small-cap stocks through brokers and traders owing allegiance to him.

On paper, Abramo is respectability personified. Over the past decade he has been listed as president or top shareholder of four publicly held investment companies. He is married, with a grown daughter. He has been a "restaurant consultant," auto dealer, and construction company operator. He has had four years of college and may even have training as an accountant.

But inquiries about Abramo bring far from routine reactions. At Greenway Capital, President John Margiotta is asked if he knows Abramo. Margiotta replies: "Who?" and hangs up the phone. A person answering the phone at Greenway, moments later, says that Margiotta is "very busy" and "not in the office." Toluca Pacific President Paul Fiorini, when asked about reports of Abramo's control of his firm, calls them a "total farce." He says he owns 100% of the firm and goes on to say: "Who is this person? I don't want my name associated with this. I don't know this person. I don't know Phil Abramo."

The reason for the reticence is understandable. According

to federal court records in recent tax-evasion proceedings against Abramo in Newark, the Saddle River (N.J.) resident lists his occupation as "consultant." But elsewhere in the court file, the FBI gives a different version of his livelihood.

Cover Story

In 1994, in an affidavit filed with the court in a bail hearing, the FBI identified him as a frequent visitor to reputed New York Mob boss John Gotti prior to his imprisonment in 1992, and alleged that Abramo held the rank of *capo* in the New Jersey organized crime family once headed by Sam "the Plumber" DeCavalcante. But sources say that since then, Abramo has risen in the ranks to No. 2 in that crime family—underboss.

Abramo is easily the highest-ranking reputed mobster to be engaged full-time in Wall Street activities. His lawyer, Harvey Weissbard, declined comment on Abramo's alleged ties to organized crime. Asked about Abramo's possible role on Wall Street, Weissbard said he had "no information of which I can respond one way or the other, and I doubt if I did know one way or the other that I would respond."

Little is known about Abramo's early life, such as which college he attended. Except for a conviction for possession of stolen property in 1971 and another in 1973 for conspiracy to distribute heroin—which yielded him a seven-year prison sentence—he has stayed out of the limelight. Even when he was indicted in 1994 in New Jersey for allegedly swindling 300 people nationwide out of $1 million—they were sold phony "lines of credit"—he received no publicity and continued to work on the Street.

Indeed, by the time he was indicted in the credit-line scheme, Abramo already had a lengthy, ostensibly legitimate track record. In the late 1980s Abramo founded publicly-held investment companies with names such as Cambridge Investment Service Corp. and American Acquisition Corp. (SEC filings by these companies show they did little but file papers with the SEC.) According to papers filed by Abramo with the SEC for the investment companies, Abramo was a "restaurant consultant to Northern Roses Inc. (Miami, Fla.)," during 1982, and "was also a restaurant consultant to Bagel Nosh Inc. (1983 and 1984—New York, N. Y.)." Abramo's Bagel Nosh connection is significant, because the company was brought public by Thomas J. Quinn.

Quinn was one of the most prominent figures in the penny-stock world, but his association with Abramo has never been made public, although regulators have long suspected it. When Quinn was jailed in France in 1988 for securities fraud, investigators say, Abramo's name was prominently displayed in a notebook that was seized from him. Calls in 1995 from Quinn's telephone to Abramo's unlisted home phone number also appeared in phone records that were recently subpoenaed by investigators seeking Quinn's assets. (He was successfully sued by the SEC for securities fraud in 1989 and owes millions of dollars in civil penalties.) Indeed, Abramo was subpoenaed to testify before the SEC in 1989 during a probe of Quinn, but he invoked his Fifth Amendment privilege against self-incrimination. Efforts to reach Quinn for comment were unsuccessful.

The Quinn-Abramo connection could become significant in the months ahead because of an ongoing federal grand jury probe in California into possible irregularities in the trading in Solv-Ex Corp., an Albuquerque-based company that claims to have a process for retrieving oil from tar sands. (Solv-Ex officials denied knowledge of any trading irregularities and claimed that a private investigator's report, which they refused to release, indicated there was no manipulation.) According to sources close to the grand jury probe, Abramo and Quinn are among those who have been a subject of the investigation.

Three men invited the head of a penny-stock brokerage for a walk. One of the men stuck a gun in his ribs. "From now on," he was told, "you're retailing our stocks"

Today, Abramo faces a one-year prison term for tax evasion. It was a plea bargain—the guilty plea to tax evasion in return for dropping of the loan-scheme charges. He is scheduled to report to prison on Jan. 7. While he may well handle his Street interests while incarcerated, in some quarters there is concern that his departure will mean an increase in violence.

The level of violence is becoming worrisome. Early in November, a broker at a New York-area brokerage was severely beaten, his arm broken, in the lobby of the firm. As so often happens in such situations, he did not notify the police. His offense: He moved from a Mob-controlled firm, taking his customers with him, and dared to sell their stocks. Sell pressure on stocks is just what the Mob despises (unless,

of course, they are short). It can sour a deal—and the often immense profits that can come with it.

THE DEAL

Mama Tish's International Foods is a Chicago-based company that makes Italian ices. But when it went public last month, it was red-hot. The IPO went for $5, but on the first day of trading, the shares moved as high as $9.75—a sure sign of "flipping," in which favored investors cash out of the stock immediately.

Cover Story

Alas, the Mama Tish IPO was canceled—wiping out all the trades—when the underwriter, a Long Island firm called Landmark International Equities, got into a heated dispute with the firm that clears its trades. The company and underwriter were disappointed—and so were some people who hate to be disapppointed.

Even before the deal began, traders began receiving phone calls warning them not to short the IPO, which might have driven down prices. According to Wall Street sources, among the people who would have profited heavily from the Mama Tish IPO is John Gotti Jr., reputed acting boss of the Gambino family and son of the imprisoned Gambino crime family chieftain. According to Wall Street sources, "Junior" Gotti is the hidden owner or control person of one of the brokerages—other than Landmark—that was active in the Mama Tish deal. Had the deal gone through, any Gotti people involved in the deal would have profited handsomely from the 80% difference between the offering price and the trading price of the shares. Gotti was unreachable for comment. A company official said he did not know of any Mob involvement in the IPO.

"Junior" Gotti, reputed acting boss of the Gambino crime family, is said to be the hidden owner of a brokerage active in the recent failed IPO of Mama Tish, a Chicago food outfit

If "Junior" Gotti represents the younger generation of reputed mobsters on the Street, the older generation would be epitomized by John "Sonny" Franzese. Franzese has been described by law-enforcement authorities for decades as an influential, feared mobster who allegedly was the former underboss of the Colombo crime family. Sources say Franzese joined the Mob's rush to the stock market after his release on parole from a 50-year term for bank robbery in 1994. According to sources, the 77-year-old reputed Mob elder described himself to associates earlier this year as controlling, through a confederate, Monitor Investment Group, whose brokers allegedly ripped off the West Coast investor by promising a guaranteed runup. Monitor chairman William F. Palla denies that Franzese or organized crime has ever played any role in the firm.

Monitor, which ceased active operations last June, is described by former employees as a center for widespread stock manipulation—specifically involving boxing of International Nursing Services, Beachport Entertainment, and Innovative Medical Services. Officials of the three companies say they were unaware of any irregularities in the trading of their stocks. International Nursing Chairman John Yeros, however, concedes he felt something was amiss at Monitor when he attended a presentation the brokerage sponsored for International Nursing at a downtown hotel—and found that Monitor had hired a hooker to "service" the brokers in attendance. Palla says he heard of the "hooker incident" but denies Monitor retained that person.

If Franzese in fact became involved in the penny-stock business, it would be a potent sign of the lure of the penny-stock business to the Mob. But like Abramo, Franzese may have to cool his interest in the market for a while. He was recently found to have violated the terms of his parole and was ordered back to prison.

THE FUTURE

There are plenty of young mobsters ready to take the place of any old-timers who might fall victim to any future law-enforcement crackdown. One Brooklyn-based prosecutor, a specialist in the Mob, observes that "there are a lot of wannabes getting jobs on the Street, working in these places, cold-calling." That might explain why there seems to be no shortage of people willing to carry guns into brokerage houses and beat up traders in front of witnesses, or telephone threats to traders.

One reputed up-and-comer in the Street's Mob contingent is Dominick "Black Dom" Dinassio, who is said by Street and law-enforcement sources to hold sway over Euro-Atlantic Securities, a Manhattan brokerage that is active in penny stocks. According to a source in the Manhattan District Attorney's office, Dinassio is allegedly an associate in the Colombo crime family.

Law-enforcement sources say that Dinassio has lately been observed in the company of Longo, Malangone's longtime partner. Sources say a short-seller who was active in shorting Hanover stocks, John Fiero, told police recently that Dinassio threatened him for his trades in one stock brought public by Euro-Atlantic, Hollywood Productions Inc. Fiero refused comment and company officials did not return phone calls. Contacted at Euro-Atlantic's office in lower Manhattan, Dinassio declined to discuss his role at the firm. Asked about the allegations that he was connected to organized crime, he replied: "What? I think you're crazy, buddy. I'll talk to you later," and hung up. Euro-Atlantic officials did not return phone calls.

Although whistle-blowers in Mob-run firms are rare, the increasing violence is beginning to enter the public record. At Monitor, the firm Franzese allegedly claimed to control, an incident last January led to a rarity in this world—a lawsuit. In a suit filed in U.S. District Court in Manhattan, former broker Robert Grant contends that he was "maliciously and violently struck, battered, beaten, pummelled, pushed, punched, and attacked" by Monitor employees at the instigation of Palla and another manager. At one point, the suit says, Grant was beaten with a chair. The lawsuit does not say so, but witnesses say that another broker was also viciously assaulted. Neither Grant nor the other broker would comment, and Palla says he was in Philadelphia at the time

of the incident, which he describes as a "fight." One witness says Monitor management suspected that the two brokers may have been short-selling Monitor's favorite stocks.

Some of the most violent, crudest elements to come to the Street are part of its fastest-growing contingent—the Russian Mob, based in the Brighton Beach section of Brooklyn. "Over the past couple of years, they've put people in the [brokerages], kids with clean records, and they're washing money legitimately," says one law-enforcement official who is intimately familiar with Russian organized crime. The offspring of two major Russian mob figures, he notes, have been active on Wall Street.

Cover Story

The Mob's fascination with Wall Street is understandable, for they have had little to fear from law enforcement or regulators. If the authorities, finally, act against Mob members who are active on the Street, it will be the first such prosecution since 1973, when three major Mob figures were imprisoned for securities fraud. At the time, the Mobsters were vanquished because one of their confederates became a government witness. "It's practically impossible to prosecute these people unless you have a turncoat, somebody who can walk you through all those transactions," notes Ira Lee Sorkin, a former SEC regional director who was involved in the 1970s prosecutions. So long as the Street continues to keep silent on the Mob in its midst, organized crime will continue to be the silent partner of the financial markets.

DID THE NASD LOOK THE OTHER WAY?

He was the head of a penny-stock brokerage that has had its share of regulatory problems. This, he has told friends, is what happened to him early in 1996:

Two men appeared at his midtown Manhattan office. They went for a walk. One man stuck a revolver in his ribs. "From now on," he was told, "you're retailing our stocks."

According to sources, this man's brokerage did not retail the two mobsters' stocks. Nor did he contact regulators or the National Association of Securities Dealers. Instead, he got in touch with the only power that seemed to make sense: a protector in the Mob. Somehow, the problem was "straightened out." Asked about the incident by BUSINESS WEEK, he responds: "I don't want to get involved."

If this penny-stock exec showed a less than civic-minded attitude toward law enforcement, it's understandable—particularly if the allegations of a 57-year-old former NASD official, Massood Gilani, prove valid. Gilani worked in the Special Investigations Unit of the NASD's New York office, checking complaints of improprieties and reporting them to his superiors for further action. He paints a picture of widespread indifference toward customer complaints that might have been a tip-off of Mob infiltration of Hanover Sterling & Co.

From 1992, when Gilani started working at the NASD in New York, until late 1995, when he left, there was disturbing talk in the hallways of the agency's New York office. "The rumor was that some of these firms were run by the Mafia . . . the word was that some of them, including Hanover Sterling, were used to launder drug money," he says.

Gilani says he received an unusually large volume of complaints about Hanover from customers, most involving unauthorized trades—something Gilani suspected might have indicated stock "parking." "They were definitely pushing the stocks up, and it definitely looked like parking," says Gilani. From October, 1993, to June, 1994, he says in the suit, there were at least 31 customer complaints against Hanover, almost all alleging unauthorized trading. Among the complaints, he says, were several against Roy Ageloff, who Gilani says was widely known at the NASD to be the power behind the firm.

MASSOOD GILANI: *The ex-NASD examiner suggested a wider probe into Hanover*

Sources have told BUSINESS WEEK that Ageloff has ties to the Genovese crime family.

Gilani says he "suggested that a wider investigation be conducted by enforcement and market surveillance." The response? "I was told to mind my own business." At one point, he was told by a supervisor "very bluntly that [the brokerages] pay your paycheck. You don't bite the hand that feeds you."

NASD officials note that they took action against Hanover Sterling—but not until after Hanover went out of business. Gilani says that he urged the NASD to act long before the company folded—in time, perhaps, for regulators to act before its failure brought down the company's clearing firm, Adler, Coleman.

Gilani is hardly an impartial source: He was fired by NASD in 1995, and he's suing for racial discrimination. (NASD officials decline comment on the suit.) Still, his comments regarding the NASD's handling of Hanover Sterling are damning.

To be sure, Gilani hardly had much clout at the NASD, since he was in the doghouse much of the time. One lawyer pursuing his suit, Aegis J. Frumento of Singer Zamansky LLP in New York, notes that the Iranian-born Gilani "agitated a great deal on discrimination and employment policies." Gilani feels he was ignored because of the "corporate culture at the NASD." And if his tale of indifference proves correct, it would seem that the NASD is a far cry from being the Eliot Ness of Wall Street.

By Gary Weiss in New York

MARIBETH NG

GET THE MOB OFF WALL STREET

Organized crime is infiltrating the small-cap stock market, and neither the National Association of Securities Dealers nor the authorities are taking it as seriously as they should. As many as two dozen small brokerages are involved, people are being threatened and beaten, investors are being cheated, and companies seeking to raise capital are being exploited. A piece of America's capital markets is being corrupted, and unless this is stopped quickly, it's likely to spread (page 92).

So far, Mob activities seem confined to stocks traded in the over-the-counter "bulletin board" and NASDAQ small-cap markets. Issues on the big exchanges appear free of exploitation. Yet criminals have gained control of brokerage firms that make markets in hundreds of stocks. Sometimes they run stocks up, sell them off to unsuspecting investors, and later short the shares. They use intimidation to create artificially wide spreads between bid and ask prices to make profits.

NASDAQ, the Securities & Exchange Commission, and law enforcement agencies appear to be treating Mob infiltration as a minor affair. Corrupting Wall Street threatens the capital markets of America and its economic health. It's time to act.

ONE HUNDRED FIFTH CONGRESS

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February 6, 1997

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Department of Justice
Constitution Ave. and 10th Street, N.W.
Washington, D.C. 20530

The Honorable Arthur Levitt, Jr.
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Ms. Mary Schapiro
President
NASD Regulation, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

Dear Attorney General Reno, Chairman Levitt, and Ms. Schapiro:

I am writing with reference to press reports, "The Mob on Wall Street," Business Week (December 16, 1996) at 92, on the results of a three-month investigation into the alleged infiltration of the small-cap stock market by organized crime while regulators and law enforcement looked the other way. Notes the Business Week editorial page: "Organized crime is infiltrating the small-cap stock market, and neither the National Association of Securities Dealers nor the authorities are taking it as seriously as they should." If true, this is an outrage.

Please provide me with a report by the close of business on Friday, February 28, 1997, on the extent of this problem and what you have done and what you plan to do in the future to address it.

Thank you for your cooperation and attention to this request.

Sincerely,

JOHN D. DINGELL
RANKING MEMBER

Enclosure

cc: The Honorable Thomas J. Bliley, Jr.
The Honorable Michael Oxley
The Honorable Thomas J. Manton

U. S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

APR 2

The Honorable John D. Dingell
Ranking Minority Member
Committee on Commerce
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Dingell:

This is in response to your letter to the Attorney General of February 6, 1997, relating to an article in Business Week alleging infiltration by organized crime into certain segments of the stock market. I can assure you that before the recent media reports surfaced alleging the involvement of La Cosa Nostra figures in the securities industry, the Department of Justice was addressing the situation and will continue to do so.

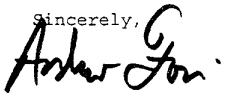
As you know, the Department of Justice has a long-standing commitment to the eradication of organized crime infiltration into legitimate industries. The Department has in the past brought a number of successful cases, many using the Racketeer Influenced and Corrupt Organizations Act (RICO), to address organized crime infiltration into various industries and organizations, including the construction industry, various major international labor unions, the fuel oil industry, the carting industry, and the legalized gaming industry. The Department currently has under indictment two significant RICO cases in New York dealing with La Cosa Nostra control of the carting industry. The indictment in United States v. Gigante, et al., brought in the Southern District of New York, charges the defendants with, inter alia, RICO, extortion, fraud, bribery, illegal labor payoffs, and money laundering relating to the Genovese and Gambino La Cosa Nostra families' alleged control of the carting industry in Westchester and Rockland Counties, New York, and in parts of Connecticut. Similarly, in United States v. Hickey, et al., brought in the Eastern District of New York, the indictment charges Andrew Russo, the acting boss of the Colombo La Cosa Nostra family, and others with RICO, fraud, bribery, and money laundering relating to the Colombo La Cosa Nostra family's alleged control of the carting industry on Long Island.

The Honorable John D. Dingell
Page 2

The Department views aggressive pursuit of organized crime involvement in the securities industry as no less important. You can be assured that we will attack any attempts by organized crime groups to assert their influence over legitimate businesses relating to the public trading of securities with the same vigor with which we have attacked their infiltration of other industries. As I am sure you can appreciate, however, with respect to the specific allegations discussed in the Business Week article, the Department of Justice can neither confirm nor deny the existence of an investigation.

Please do not hesitate to contact me if we can be of further assistance with regard to this or any other matter.

Sincerely,



Andrew Fois
Assistant Attorney General

cc: The Honorable Thomas Bliley, Jr.
Chairman

THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

February 25, 1997

The Honorable John D. Dingell
Ranking Member
Committee on Commerce
U.S. House of Representatives
2322 Rayburn House Office Bldg.
Washington, D.C. 20515-6115

Dear Congressman Dingell:

This is in response to your letter of February 6, 1997, concerning a Business Week article entitled "The Mob on Wall Street."

The article set forth disturbing allegations about efforts by organized crime to obtain footholds in the small-cap sector of our equities markets. My senior staff, including Director of Enforcement Bill McLucas, General Counsel Richard Walker, and Legislative Affairs Director Kaye Williams, have had preliminary discussions with your Counsel, Consuela Washington, to arrange for the most effective way to respond to your request.

We propose to arrange for a confidential briefing for you and/or Consuela to discuss the Commission's current efforts and future plans to combat organized criminal activity in our securities markets. In addition, in advance of such a briefing, I am enclosing three releases regarding recent actions we have taken against individuals or entities that are accused of engaging in criminal securities fraud. In each of these matters, we worked in close cooperation with criminal law enforcement authorities.

Please contact Kaye Williams at 942-0014 to schedule a convenient time for a briefing.

Sincerely,

Arthur Levitt

Enclosures - to CW

NASD REGULATION

NASD Regulation, Inc.
1735 K Street, NW
Washington, DC 20006-1500
202-728-8140
Fax 202-728-8075

Mary L. Schapiro
President

February 28, 1997

The Honorable John D. Dingell
Ranking Minority Member
Committee on Commerce
U.S. House of Representatives
Room 2322, Rayburn House Office Building
Washington, DC 20515-6115

Dear Representative Dingell:

This is in response to your February 6, 1997, request for information about NASD Regulation's enforcement efforts in The Nasdaq SmallCap Market. In particular, you asked what our response was, is, and will be, to alleged infiltration of that market by organized crime, as some media have reported. Vigorous enforcement of our nation's securities laws and rooting out anyone breaking those laws is the top priority of NASD Regulation. This is true whether it occurs in The Nasdaq Stock Market, the over-the-counter market or any other area over which we have jurisdiction. In addition to our own enforcement initiatives, we work closely with criminal prosecutors to assist their prosecution and punishment of the most serious offenders beyond the limits of our sanctions.

The influence of organized crime in our markets is an issue that must be aggressively addressed. We have been working with the Organized Crime Unit of the FBI and other federal law enforcement agencies on several ongoing sensitive matters that we would be pleased to discuss with you in a private briefing. As you know, our jurisdiction is limited to bringing disciplinary actions against registered individuals and firms that are NASD members. What we can bring to the "criminal enforcement table" is the necessary market and technical expertise for government law enforcement agencies to conduct significant and effective criminal investigations.

With respect to the December *Business Week* article referenced in your letter, prior to publication, we had significant ongoing investigations of our own involving all but one of the member firms and many of the nineteen Nasdaq or OTC Bulletin Board issuers mentioned in the article. Since that time, we initiated an investigation of the one remaining firm and conducted a review of trading activity in the remaining securities. Our involvement with law enforcement agencies on these firms and issuers can be discussed with you in a private briefing.

To coordinate all of our work with criminal law enforcement officials around the country, we are also setting up an organization-wide task force within the NASD. The task force will be headed by Barry Goldsmith, NASD Regulation's Executive Vice President of Enforcement. Working with him will be representatives from The Nasdaq Stock Market and our departments of Corporate Finance, Disciplinary Policy, Market Regulation and Member Regulation. The task force will provide direct assistance to criminal authorities involved in investigations and undercover operations involving the securities industry. In addition to focusing on the activities of brokerage firms, the task force will review the finances and operating activities and characteristics of those issuers who we believe may pose a threat to the investing public.

Before further discussing our current cooperative activities to combat crime in our markets, I will describe our own ongoing Nasdaq SmallCap enforcement initiative. In addition, I will report on The Nasdaq Stock Market's recent proposed heightened listing standards for the SmallCap Market. While not specifically directed at criminal activity, these new standards will make it far more difficult for criminals who victimize investors to operate in that market. I will then provide you with information about our current efforts to rid our membership and our markets of criminal activity.

I. NASD Regulation's SmallCap Enforcement Initiative

In 1996, NASD Regulation brought 1,200 disciplinary actions, nearly a 12% increase over 1995. Nearly 400 registered individuals were barred from the securities industry and we suspended some 200 more. Our enforcement efforts increased by 20% the number of firms expelled from the Association. Firms and individuals alike have been sanctioned and expelled from the securities industry for a single reason -- they violated the securities laws and broke our rules to take advantage of the investing public.

With respect to the SmallCap market, we launched a special national enforcement effort in 1995. This was in response to concerns that sales practice abuses previously associated with the over-the-counter penny stock market were occurring in the Nasdaq SmallCap Market. These practices - - if not comprehensively and aggressively addressed - - threatened to undermine the integrity of that market. As a result, the NASD launched a nationwide enforcement initiative concentrating primarily on sales practice and other abuses occurring in the SmallCap Market. From July 1995 through year-end 1996, we devoted more than 15,000 workdays to these investigations. On an annualized basis, this is the equivalent of approximately 90 people working on these cases on a full time basis.

Several major fraud cases have already resulted from this initiative, with more expected to follow in 1997. Cases filed to date include three against Stratton Oakmont, Inc., a notorious securities recidivist. Stratton, its President and head trader were expelled from the Association in December of last year. Other notable cases growing out of our SmallCap initiative include La Jolla Capital Corp. (disciplinary action pending against La Jolla, its President, and 27 registered individuals encompassing sales of 15 securities with violative revenues of approximately $700,000) and Sterling Foster & Co., Inc. ($53 million alleged illegal profit resulting from boiler room sales practices, market manipulations and IPO violations). Following the filing of our Sterling Foster case, the FBI in New York executed a search warrant on the firm's Melville, Long Island offices. There are other grand jury and criminal investigations growing out of our SmallCap initiative that we would be pleased to brief you on.

We anticipate being able to bring even more cases of this type due to the recent increase in staffing levels. Our enforcement group in Washington, which brings many of these cases, has grown from 46 to 81 in two years. Current staffing includes twenty attorneys, eight supervisors and 37 investigators. Computer proficient, our investigators typically have advanced accounting, business or law degrees and are able to take advantage of our surveillance systems to detect and investigate fraud.

II. Tougher Listing Standards for the SmallCap Market

On November 6, 1996, the Board of Directors of The Nasdaq Stock Market approved changes to further strengthen both the quantitative and qualitative standards for issuers listing on the Nasdaq SmallCap Market. This would enhance by at least 50% the financial criteria necessary to qualify for listing and would eliminate any stock that trades at less than $1. The SmallCap market would be subject to the same

corporate governance standards that have applied to the Nasdaq National Market. These include a minimum of two independent directors; an audit committee with a majority of independent directors; an annual shareholders meeting; and shareholder approval for large, below-market issuances. In addition, Nasdaq is currently evaluating whether to impose a requirement that auditors of Nasdaq-listed companies be subject to peer review. If accepted as proposed, more than 400 SmallCap companies would be affected by the change. These new, more stringent listing standards will also have the effect of making it far more difficult for criminals and those who seek to subvert our markets from doing so. They have been submitted to the SEC for approval.

III. Assistance to Criminal Authorities

As we have shown, NASD Regulation aggressively investigates allegations of manipulation, fraud and illegal behavior in our markets. In cases where we have the jurisdictional authority to act, we file our own disciplinary actions and serious sanctions are imposed. In cases that require governmental involvement or where our jurisdictional limitations preclude us from acting, we pursue them cooperatively with other regulators and law enforcement officials.

In the last four months alone, NASD Regulation's work with the FBI, U.S. Attorneys, Justice Department, and state law enforcement agencies has resulted in criminal charges against more than 120 individuals. In November 1995, the U.S. Attorney in Las Vegas announced that a federal grand jury there returned securities fraud and RICO indictments against thirty defendants for the alleged bribery of stockbrokers and fraudulent issuance of Teletek stock, a Nasdaq SmallCap security. Two weeks ago, six guilty pleas were unsealed in this case, bringing to twelve the number of people who have acknowledged their role in the scheme. For more than a year, NASD Regulation examiners spent hundreds of hours working with prosecutors and federal agents, developing this important case. The U.S. Attorney explicitly acknowledged our assistance in its News Release publicizing these actions.

Late last year, federal prosecutors in New York indicted 45 stock promoters, executives and brokers for making or accepting bribes to promote the stock of certain issuers. Some of these bribes exceeded $100,000 and represented as much as 40% of the value of the transaction. NASD Regulation lawyers and examiners in our New York and Washington offices contributed hundreds of hours to this cooperative effort. In addition to this substantial personnel commitment, we provided market information, technical expertise and other assistance that contributed to the success of this undercover sting operation. In addition to these criminal prosecutions, NASD Regulation also brought its own disciplinary proceedings against ten registered brokers implicated in the operation. We would be pleased to provide you or your staff with more specific details about our role in this successful undercover operation.

For the past several years, NASD Regulation has had a full-time examining staff assigned to the FBI in Newark, New Jersey. These examiners have been instrumental in helping the United States Attorney in New Jersey obtain criminal convictions of many individuals associated with low-priced stocks, including stock manipulator Richard Bertoli (100 months in prison) and notorious stock promoter Eric Wynn. Wynn, along with four others, were charged in a 13-count indictment alleging criminal conspiracy, securities fraud and wire fraud in connection with a stock manipulation scheme. In July of 1995, following a six-month jury trial, Wynn was convicted on all counts and sentenced to 52 months in prison and a $50,000 fine. Eight of his co-conspirators were convicted or pled guilty, most being incarcerated. Commenting on our role in this case, FBI Director Louis Freeh, recently commended NASD Regulation for the "vital role" it played "during several substantial investigations involving the securities markets." Freeh called the work of NASD Regulation staff "tireless" over the last several years, and added that they "contributed

immensely to the convictions of more than 30 persons." In December, five NASD Regulation staff were awarded formal commendations by the FBI in connection with this matter.

NASD Regulation has taken a leadership role in training and meeting with federal, state and local prosecutors to interest them in our cases and educate them about potential criminal abuses in our markets. We have strong institutional relationships with these agencies and regulatory intelligence flows frequently between us. For example, beginning in 1996, our New York District office commenced a series of meetings with the FBI's New York Organized Crime Squad. Our District staff have provided these FBI representatives with securities firm examination reports, as well as making our most knowledgeable personnel available to the Bureau for interviews. We provided, and will continue to provide, the FBI with information about firms that we suspect are involved in criminal activity, including organized crime.

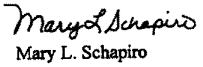
In December of last year, NASD Regulation organized a meeting with law enforcement agencies and securities regulators in the New York area to address the problem of criminal activity in the securities industry. Attending were representatives from thirteen different law enforcement and regulatory agencies, including three U.S. Attorneys offices and the FBI Organized Crime Unit. There have been several follow-up meetings with individual prosecutors, the details of which we can provide you in a private briefing.

In addition to the creation of the Association-wide task force described above, we have undertaken to expand our already significant efforts to combat crime in our markets. Included in these efforts is our providing assistance to law enforcement agencies in undercover activities similar to the recent FBI "sting" operation described above. We have also entered into and are presently negotiating a number of Memoranda of Understanding (MOU's) with federal law enforcement agencies that involve investigations of registered entities having possible connections to organized crime. We would be pleased to brief you privately about the details of these MOU's and the nature of ongoing investigations, including undercover operations.

In conclusion, I can assure you that NASD Regulation will not tolerate criminal activity, organized or otherwise, in our markets or the association of criminals with our member firms. Although the number of firms mentioned in the *Business Week* article as suspected of having ties to organized crime represent a tiny portion of our 5,500 member firms, this is an area of zero tolerance. Likewise, while only a handful of the more than 1,400 securities listed on the Nasdaq SmallCap Market are reported as being subject to criminal manipulation or infiltration, we will continue to deal with conduct of this type swiftly and forcefully.

I hope this information is helpful. We would be pleased to brief you or members of your staff on any of the matters raised in this letter, as well as provide information concerning current confidential matters under investigation. I will call your office to set up an appointment.

Sincerely,



Mary L. Schapiro
President
NASD Regulation, Inc.

cc Mr. Frank G. Zarb

The Honorable Thomas J. Bliley, Jr.
The Honorable Michael Oxley
The Honorable Thomas J. Manton

ONE HUNDRED FIFTH CONGRESS

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TED STRICKLAND, OHIO
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JAMES E. DERDERIAN, CHIEF OF STAFF

U.S. House of Representatives
Committee on Commerce
Room 2125, Rayburn House Office Building
Washington, DC 20515–6115

November 26, 1997

The Honorable Janet Reno
Attorney General
Department of Justice
Constitution Ave. And 10th Street, N.W.
Washington, D.C. 20530

The Honorable Arthur Levitt, Jr.
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Ms. Mary Schapiro
President
NASD Regulation, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

Dear Attorney General Reno, Chairman Levitt, and Ms. Schapiro:

I am writing to follow up on my letter of February 6, 1997 (enclosed) with reference to organized crime's inroads into the small-cap stock market and, in that regard, to congratulate you on the criminal indictments, and companion SEC enforcement actions, announced yesterday. Given that Michigan residents were among the investors defrauded in this major scheme involving Healthtech International stock and alleged members of the Bonanno and Genovese crime families, I am particularly appreciative of your actions in this matter. This concrete proof of the Department of Justice's assurances in April that you were "addressing the situation and will continue to do so" is appreciated by the honest men and women on Wall Street and is crucial to maintaining investor confidence in the U.S. stock market.

I expect to receive shortly a GAO report regarding listing and maintenance standards on the NASDAQ Smallcap Market and their application in the fraud involving Comparator Systems Corporation. Based on the findings and recommendations of that report, I will be looking at

possible regulatory and/or legislative remedies to assist you in your law enforcement efforts and to better protect investors, and would appreciate your input as well.

Thank you for your continuing efforts.

Sincerely,

JOHN D. DINGELL
RANKING MEMBER

Enclosure

cc: The Honorable Tom Bliley, Chairman
Committee on Commerce

The Honorable Michael Oxley, Chairman
Subcommittee on Finance and Hazardous Materials

The Honorable Thomas J. Manton, Ranking Member
Subcommittee on Finance and Hazardous Materials

U. S. Department of Justice
Criminal Division

Office of the Assistant Attorney General *Washington, D.C. 20530*

TO DOF PS CO File

December 15, 1997

The Honorable John D. Dingell
U.S. House of Representatives
Washington, DC 20515

Dear Congressman Dingell:

I greatly appreciate your letter of November 26, 1997, expressing support for our recent efforts to remove organized criminal elements from the securities markets. We have stepped up our efforts in this regard in response to some evidence that penny stocks in particular present an attractive target to organized crime. Although we believe that the mob has failed to date to secure a foothold on Wall Street, we should take nothing for granted.

Maintaining a high public confidence in the integrity of the securities market is a high priority. I look forward to working with you and the Committee on Commerce on this important issue.

Sincerely,

John C. Keeney
Acting Assistant Attorney General

ONE HUNDRED FIFTH CONGRESS

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TED STRICKLAND, OHIO
DIANA DeGETTE, COLORADO

JAMES E. DERDERIAN, CHIEF OF STAFF

U.S. House of Representatives
Committee on Commerce
Room 2125, Rayburn House Office Building
Washington, DC 20515–6115

December 12, 1997

The Honorable Janet Reno
Attorney General
Department of Justice
Constitution Ave. and 10th Street, N.W.
Washington, D.C. 20530

The Honorable Arthur Levitt, Jr.
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Ms. Mary Schapiro
President
NASD Regulation, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

Mr. Mark J. Griffin
President
North American Securities
Administrators Association, Inc.
One Massachusetts Ave., N.W.
Suite 310
Washington, D.C. 20001

Dear Attorney General Reno, Chairman Levitt, Ms. Schapiro, and Mr. Griffin:

I am writing with reference to press reports, "Ripoff! The secret world of chop stocks -- and how small investors are getting fleeced," Business Week (December 15, 1997) at 112, on the results of a six-month investigation into rampant fraud in micro-cap stocks. Vast, interlocking networks of rogue brokers, stock promoters, and mobsters obtain shares in companies at dirt-cheap prices and then unload them on an unsuspecting public at massive, undisclosed markups. The reputable firms in the industry (which are an overwhelming majority) and federal and state regulators appear to be unable to prevent these illegal and dangerous practices. Notes Business Week: "What emerges is a shocking picture of a problem that has spun out of control."

Please provide me with a report by the close of business on Friday, January 23, 1998, on the extent of this problem and what you have done and what you plan to do in the future to address it. I am enclosing a copy of my letter to the U.S. General Accounting Office asking them to conduct certain audits and to submit a report on this matter. Your cooperation with that request would be appreciated also.

Swift and strong actions are necessary to restore the integrity of these markets and to protect investors. I look forward to receiving your analyses and ideas.

Sincerely,

JOHN D. DINGELL
RANKING MEMBER

Enclosures

cc: The Honorable Tom Bliley
The Honorable Michael Oxley
The Honorable Thomas J. Manton

Mary L. Schapiro
President

NASD Regulation, Inc.
1735 K Street, NW
Washington, DC 20006-1500
202 728 8140
Fax 202 728 8075

January 23, 1998

Honorable John D. Dingell
Ranking Member
Committee on Commerce
Room 2125 Rayburn House Office Building
Washington, D.C. 20515-6115

Dear Congressman Dingell:

This letter is in response to your December 12 letter regarding the December 15 *Business Week* article titled "Ripoff! The Secret World of Chop Stocks — and How Small Investors Are Getting Fleeced." It provides the report you requested on the extent of this problem, what we have done, and what we plan to do in the future to address it.

First, as you note in your letter to us, we would like to underscore that the overwhelming majority of firms in the industry are reputable. The problems chronicled in the article are rare, and the coordinated efforts of securities regulators seek to make them even more unlikely.

With regard to the specific allegations reported in the *Business Week* article, — as with all allegations of wrongdoing — the NASD aggressively investigates charges of manipulation, fraud, and bribery in the nation's securities markets. Regulators and law enforcement officials are working together to assure that the securities markets are safe for investors. Comment in this letter on the progress of specific non-public, ongoing investigations, or efforts to address misconduct in a specific area of the market, while underway, would be inappropriate and would jeopardize our actions against wrongdoers. If you require such information regarding open investigations, we will provide you and your staff a confidential briefing. We are able to comment publicly on several aspects of the article, however.

We believe that the article does not fairly describe NASD's accomplishments in cleaning up illegal activity in low-priced securities. With regard to the firms that were referenced in the *Business Week* article, we can report that seven of them are no longer in business, and the NASD played an important role in most of those firms' demise. For example, Stratton Oakmont and Euro-Atlantic were expelled as a result of NASD Regulation disciplinary actions. Another firm, A.R. Baron, was indicted by the Manhattan District Attorney's office for, among other things, grand larceny and enterprise corruption. NASDR played an important role in developing this case, as reflected in the DA's press release announcing the indictments.

The article acknowledges that two of the individuals it mentions, Meyer

Blinder and Robert Brennan, have long ceased any registration with a member firm. The NASD brought the first significant cases against the firms through which Blinder (Blinder Robinson) and Brennan (First Jersey and Hibbard Brown) operated. An NASD decision subsequently expelled Hibbard Brown.

The article also states that Meyers Pollock Robbins was a "160-broker national firm that had escaped attention until the Nov. 25 indictments." However, Meyers Pollock had indeed attracted attention from regulators. NASDR has two outstanding complaints against the firm (issued in August 1996) alleging that the firm and several of its representatives defrauded customers by making untrue statements to customers and sold securities when no registration statement had been filed. The second complaint alleges that the firm effected transactions as principal at prices that were not fair. Furthermore, in March of last year, the SEC filed a lawsuit in federal court alleging violations of the antifraud and registration provisions of the federal securities laws in the offering of $13.9 million in debt securities by the firm and its president, Michael Ploshnick, among others. The SEC acknowledged the assistance of the NASD in conducting the investigation that led to this action.

The article also notes that on November 13, 1997, "the U.S. Attorney in Brooklyn charged 13 people — brokers, Mob associates, and officials of two brokerage firms — with manipulation the prices of thinly traded micro-cap stocks." The action involved Hampton Securities, a firm that NASDR had expelled weeks prior to the indictment for denying our examiners access to their offices. Our continuing cooperation with the US Attorney on this matter was noted in the announcement of the indictment.

Finally, the allegation in the article by an anonymous "chop house executive" of bribery of an NASD examiner is extremely serious. The NASD has no knowledge of such an event. Despite repeated requests, *Business Week* has been unable to disclose the identity of the accused person. We made a formal written request for the information underlying this accusation by a questionable anonymous source on December 5, 1997, and on December 10 we were informed by the McGraw-Hill Companies that "*Business Week* does not know and has never been advised of the identity of the NASD employee referenced at pages 114 and 118."

While much needs to be done — unfortunately, securities fraud has yet to be eliminated — we provide below a description of our efforts to date in combating microcap fraud and our plans for the future.

The Over-The-Counter Market

Before we address the questions posed by your letter, I believe it would be useful to describe the environment in which many of these "chop stocks" exist. The NASD has certain regulatory responsibilities that extend beyond The Nasdaq Stock Market to what is known as the OTC or over-the-counter market. The over-the-counter market is a vast amalgam of publicly traded companies that list neither on Nasdaq nor on any exchange. Contrary to a popular misconception, often perpetuated by unscrupulous operators, the over-the-counter market is not Nasdaq. The two are separate and distinct. It is in the thinly traded, microcap securities that characterize the over-the-counter-market where we find greatest potential for fraudulent activity.

There are several reasons for this. First, thinly traded stocks typically have a small market capitalization. Accordingly, they are more easily subjected to manipulative practices by unscrupulous brokers, issuers, and promoters. Second, a significant number of OTC companies report absolutely no information to the SEC, making their financial situation a virtual blank slate to investors. While some of these companies make financial information available, what reaches investors is not required to be subject to accounting auditing standards. Third, there is no minimum price that an OTC company must maintain to trade. Stocks in the OTC market can and do trade for mere pennies.

A part of the over-the-counter market is what is known as "The OTC Bulletin Board." While it is a system operated by Nasdaq, the Bulletin Board is markedly different and separate and distinct from The Nasdaq Stock Market. It is an electronic quotation service for subscribing members. While the system displays real-time quotes, last sale prices, and volume information in domestic securities, there is no formal legal relationship between the OTC issuers whose shares are quoted there and Nasdaq. The companies need not meet any listing standards to have their stock included in the Bulletin Board. There are no periodic reporting requirements for continued inclusion in the service; only limited phone, contact, and address information is available in the OTC Bulletin Board company listings. This system provides a centralized and automated alternative to the Pink Sheets, which historically have been published on paper once each day, but which are now available electronically via market data vendors.

A misperception that is frequently fostered by scam artists is that trading on the OTC Bulletin Board is akin to trading in a highly regulated market such as Nasdaq. They will often refer to an OTC stock as listing on "Nasdaq's OTC Bulletin Board" or on "the Nasdaq OTC" or some other deliberately confusing variation that improperly links the two. We have proposed important new rules that will change the nature of the issuers quoted on the OTC Bulletin Board and the way our members can sell OTC securities to the public. I will discuss these proposals in detail later in my letter.

The Extent of the Problem

You have asked us for our estimates of the extent of the problems that exist in this area. Unfortunately, we are unaware of any reliable estimates of the magnitude of the problems described in the *Business Week* article. This lack of information on the extent of violative conduct is to be expected, since those who would break the law take great pains to conceal their efforts. We believe that reliable estimates of this type would be difficult to make with any degree of statistical rigor, and we do not believe that they would add significantly to more precisely targeting our antifraud resources.

There is a number often referenced by the press of $6 billion of fraud annually in the microcap market. SEC Chairman Arthur Levitt was asked about that estimate during his September 22, 1997 testimony before the Senate Permanent Investigations Subcommittee's hearings on microcap fraud. He stated that the number was most likely based on a study done a number of years ago by state regulators and then, assuming that fraud growth paralleled market growth, multiplied the original estimate by market growth since that time. While he stated that his anecdotal experience tells him that there is no question that fraud will increase with market increases, he said that he has not yet seen a study of the area that he would call reliable. As stated above, estimates of fraud are difficult to

make with sufficient rigor to result in reliable findings, and we would thus also question the accuracy of the $6 billion estimate.

The Bureau of Justice Statistics could provide further information on the methods, cost, and reliability involved in compiling such statistics. That being said, we do believe that the "chop stock" problem described in the *Business Week* article is confined to a very small percentage of both our 5,500 members and their half million registered persons.

NASDR's Record

We believe as regulators that we must redouble our efforts in the microcap area. NASDR has already begun to do so. In 1996, we significantly increased the number of staff dedicated to regulation and enforcement by adding more than 150 new positions. By the year 2000, NASDR plans to spend more than $100 million to enhance its systems for market surveillance and increase examination, surveillance, enforcement, and internal audit staff.

We have begun to see the fruits of our investment. In 1997, the NASD resolved 1,211 formal disciplinary actions, an increase of more than 15 percent from the prior year. New disciplinary actions filed and settlements authorized declined from a record 1,200 in 1996 to 895 last year, reflecting in part a greater emphasis on pursuing significant, complex fraudulent conduct in the microcap market. The number of individuals barred or suspended in 1997 reached 664, an increase of more than 10 percent from 1996. Disciplinary fines collected totaled a record $9.99 million in 1997, representing an increase of almost 30 percent over 1996.

Enforcement Cases

In our focus on the microcap market, we have brought many significant cases in recent years that address the abuses reported in the *Business Week* article, including:

Stratton Oakmont — In December 1996, NASDR expelled Stratton Oakmont and barred its president and its head trader from the securities industry. The respondents have appealed the case to the SEC. This case imposed restitution and fines in excess of $1 million. Another complaint was filed last year against Stratton Oakmont and others alleging that the firm made approximately $28 million in illegal profits during the first day of aftermarket trading of five small stock offerings.

In addition, on October 16, 1997, NASDR filed a detailed complaint against 33 former principals and brokers of Stratton Oakmont. The complaint identifies at least 70 specific customers who were victimized by these brokers. While these cases take considerable time to develop, NASDR believes it is critical to not only rid the securities industry of miscreant firms and their principals but to specifically target the individual registered representatives who directly committed these violations.

Sterling Foster — In October 1996, NASDR charged Sterling Foster & Company of Melville, New York, and 15 of its executives with defrauding customers of $53 million in three 1995 initial public offerings ("IPOs").

According to the complaint, Sterling Foster agreed, before an IPO, to buy for $2 a

share the stock that insiders of the company had bought for pennies, ensuring the insiders an immediate profit. The firm would then promote the IPOs to its customers using boiler room sales practices, omitting important information and making false statements about the prospects for the company. These sales efforts resulted in enormous demand for the shares among Sterling Foster's customers, allowing the firm to sell to its customers about twice as many shares as it had sold them in the initial offerings.

The NASD's action against the firm and its principals has been stayed by a federal court pending the outcome of an ongoing criminal investigation by the U.S. Attorney's Office for the Southern District of New York. The portion of the case related to the firm's compliance officer and 10 of its registered representatives is in the final hearing stage. NASDR has worked extensively with the FBI in their criminal investigation of Sterling Foster. That investigation has resulted to date in guilty pleas by the firm's director of corporate finance and by an involved outside selling security holder.

Hibbard Brown — Working with the New Jersey Bureau of Securities, the NASD reviewed over 6,000 trades in a shell company named Site-Based Media and uncovered fraudulent activity by the Hibbard Brown firm that generated $8.7 million in illicit profits in just eight days.

Hibbard and its sole owner Richard Brown were subsequently expelled by the NASD and ordered to pay $8.7 million back to retail customers. Additionally, the firm's head trader and Brown were barred and fined. We continue to discipline former Hibbard employees for their conduct with the firm. To date, 13 branch office managers and registered representatives have been barred for their abusive sales practice activities.

A.R. Baron — In May 1997, the Manhattan District Attorney announced the indictment of A.R. Baron & Co., Inc. and the arrest of 13 individuals for cheating thousands of investors out of more than $75 million. The individuals and the firm, which is now defunct, were charged with participating in a pattern of criminal activity. Included in that pattern were lying to investors to induce them to buy certain low-priced securities; manipulating the markets in certain microcap stocks to benefit themselves and their favored customers; making unauthorized trades in the millions of dollars; refusing to honor its customers' directives to sell securities in their accounts; outright thefts from investors; and forging documents to prevent detection of their crimes. Four NASDR examiners from our Chicago office worked closely with the Manhattan District Attorney throughout this important investigation.

NASDR has brought its own cases against A.R. Baron, its principals and registered representatives. In one of those actions, the firm paid more than $1.5 million in restitution to customers and fines for charging fraudulently excessive markups in more than 200 separate transactions.

D.H. Blair — In August 1997, D.H. Blair & Co. Inc. was fined $2 million for overcharging its customers and for engaging in fraudulent pricing activity. Blair will repay an additional $2.4 million to investors who were overcharged as the result of fraudulent and excessive mark-ups in 16 securities. D.H. Blair's chief executive officer and head trader were also fined a combined $525,000. More than 3,100 retail customers from 43 states will receive restitution payments.

The firm charged excessive markups in 16 Nasdaq SmallCap securities whose IPOs were underwritten by D.H. Blair Investment Banking Corp. NASDR found mark-ups greater than 10 percent (a level considered fraudulent) in 14 of the 16 securities that D.H. Blair Investment Banking Corporation had underwritten. D.H. Blair placed virtually all of the offerings with its own customers and controlled the after-market trading in all 16 securities, in some cases for up to four and a half months after the IPO effective date.

As part of the settlement, D.H. Blair is also required to hire an independent consultant to review and monitor the firm's trading, sales, supervision, and other compliance-related policies and practices for two years. This consultant will also recommend necessary improvements, which the firm must implement.

H.J. Meyers & Company — On January 12, 1997, NASDR suspended, fined, and censured 15 current and former managers and registered representatives at H.J. Meyers & Co., Inc. for charging retail customers unfair prices or for failing to prevent that activity.

NASDR found that the salesmen were responsible for their customers being overcharged. In every case, the salesmen received gross commissions in excess of 10 percent for the sale of the common stock and warrants of Xerographic Laser Images Corp. and Integrated Security Systems, Inc., securities the firm dominated and controlled.

The actions arose from NASDR's investigation into pricing practices at H.J. Meyers. On July 25, 1996, NASDR sanctioned 22 of the firm's managers and sales representatives, and ordered the firm to pay more than $1 million in restitution and interest to more than 3,000 customers who were charged unfair prices in seven securities H.J. Meyers traded between 1990 and 1993. The firm also paid a fine of $250,000.

With the second action, a total of 37 brokers have been sanctioned, and more than $1.5 million in fines and restitution have been assessed in the H.J. Meyers investigation.

GKN Securities — On August 14,1997, GKN Securities Corp., as well as 29 brokers and supervisors, were fined $725,000 by NASDR and, in addition, will repay more than $1.4 million to investors who were overcharged as the result of a two year-long program of excessive mark-ups in eight securities. Nearly 1,300 investors from 39 states and the District of Columbia and Puerto Rico will receive payments from GKN. Three of the firm's top executives received significant fines and suspensions. All of the violations occurred at GKN's offices in New York City, Stamford, Connecticut, and Boca Raton, Florida.

From December 1993 through April 1996, GKN dominated and controlled the immediate after-market trading in eight securities it underwrote so that there was no competitive market for them. As a result, GKN was able to charge excessive markups ranging from six percent to as much as 67 percent over the prevailing market price in more than 1,500 transactions. At least 90 percent of these transactions were fraudulent because the mark-up exceeded 10 percent.

As part of the settlement, GKN must pay a $250,000 fine to NASDR, and hire an independent consultant to review the firm's trading policies and procedures for 18 months. This consultant will also recommend necessary improvements, which the firm must implement. Further, GKN is required to disclose to customers on their

confirmation slips whenever a broker's compensation exceeds ten percent of the gross transaction amount.

La Jolla Securities — On September 11, 1997, a NASDR District Committee ordered that San Diego-based La Jolla Capital Corp. be permanently barred from selling penny stocks and that five of its senior officials be sanctioned for circumventing the penny stock rules, and ordered fines and restitution of more than $950,000. Penny stocks are unlisted securities that trade over-the-counter and are priced under $5 per share.

La Jolla Capital and its President Harold B.J. Gallison were fined more than $400,000 and are jointly responsible for repaying more than 100 investors from 26 states, the District of Columbia, and British Columbia almost $400,000. The remaining four senior officials were fined a total of more than $150,000.

NASDR found that, from January 1994 through May 1995, La Jolla Capital and certain senior officials circumvented investor protection laws in approximately 140 transactions involving 15 separate securities. All of the transactions involve penny stocks. The violations occurred at La Jolla Capital's offices in San Diego, New York, Las Vegas, Bethesda, Maryland, and Modesto, California.

NASDR found that La Jolla Capital designed a system to circumvent the SEC's strict penny stock rules that ensure that investors receive honest and candid information about risk disclosure and suitability issues before they invest. La Jolla Capital had investors sign a misleading document that purported to exempt the transactions from the penny stock rule requirements. The letters were portrayed to investors as a "formality," and in some cases investors' signatures were forged. La Jolla also was found to have implemented misleading and deficient supervisory policies and procedures designed to foster the improper claim of this exemption.

Between February 1996 and October 1996, 22 other La Jolla Capital brokers and supervisors were fined and disciplined in connection with this case. The case is on appeal to NASDRs National Adjudicatory Council.

HGI and Maidstone Financial — On December 22, 1997, NASDR issued a complaint against HGI, Inc., formerly known as The Harriman Group, Inc., Maidstone Financial, Inc., and four principals of the two firms alleging fraud in connection with three public offerings. The alleged fraudulent activities resulted in more than $16.2 million in illegal profits and defrauded scores of investors in the process.

According to the complaint, the two firms, working through the four individuals, illegally profited by purchasing stock at below market prices to cover large short positions each firm had intentionally created in their inventories. In each offering, the firms purchased the covering shares from shareholders that had received their securities prior to the initial public offerings through private placements and bridge financing arrangements. In registration statements and amendments filed by the two firms with the SEC, the shares of these "selling shareholders" were restricted and therefore could not be sold for up to two years after the IPO, unless the lead underwriter granted permission.

Both firms entered into private transactions with the "selling shareholders" to purchase their shares to cover the short positions in their inventories. The firms' undisclosed distribution of these securities violates federal securities laws and NASD rules.

As alleged, the two firms, acting through the four principals, engaged in fraud by failing to disclose the private transactions with the selling shareholders, the firms' plans to distribute the selling shareholders' securities to the public, and the receipt of unlawful underwriting compensation.

Neither firm currently operates a securities business. In June 1997, HGI, which was based in Jericho, N.Y., filed to withdraw its membership from the NASD. In early December 1997, Maidstone, which was based in Manhattan, also filed to withdraw from the NASD.

Monroe Parker Securities — NASDR issued a complaint on December 23, 1997, charging Monroe Parker Securities, Inc., its vice president Bryan Herman, and its head trader Ralph Angeline with price manipulation and excessive markups in the trading of Steven Madden, Ltd. Warrants, alleging illicit profits of $4.4 million.

During late 1994 and early 1995, Monroe Parker, acting through its vice president and head trader, acquired 94 percent of the Steven Madden warrants available for public trading. The significant majority of these warrants were acquired from Stratton Oakmont Securities, Inc.—Herman's and President Alan Lipsky's former employer. After acquiring this dominant position, Monroe Parker allegedly manipulated the warrants' price and, within six days, sold its entire inventory to its retail customers at fraudulently excessive markups.

We allege that more than $3 million in profits were made from these fraudulent trades—more than $2 million were made by the firm, while Herman and Lipsky personally profited by an additional $1.1 million. Once these profits were made, Monroe Parker no longer had an interest in artificially supporting the price, and reduced its bid for the security. Within a week, the price of the warrants fell from $3.625 to $1.50 and its customers lost millions of dollars.

The complaint also charges Monroe Parker, Herman, and Lipsky with fraud in the sale of a second security, United Leisure common stock. As alleged in the complaint, customers who purchased United Leisure stock, upon the firm's recommendation, were not told that the stock came from the personal accounts of Herman and Lipsky (who were previously given the stock at no cost by Monroe Parker). Herman and Lipsky personally profited by more than $1.3 million in these transactions.

Monitor Investment Group — On January 21, 1998, NASDR issued a complaint against Monitor Investment Group and 17 of its principals and brokers. The complaint charged fraud in connection with the sale of common shares of an OTC Bulletin Board security that resulted in more than $600,000 in illegal profits. Monitor, which was headquartered in New York City, withdrew its membership from the NASD in October 1996.

In addition to the firm, the complaint names Monitor's owner and Chief Executive Officer, its President, and its Compliance Director. Also named are Jeffrey Pokross and Salvatore Piazza who are believed to have secretly controlled Monitor by participating in the day-to-day operations of the firm, infusing capital into the firm, directing brokers' activities, and bringing investment banking transactions to the firm.

The complaint alleges that Monitor—acting through Palla, Piazza and Pokross — manipulated the price of the security and exploited its position as the stock's only market maker to illegally raise the per share price from $1 to $6 3/4 over a two-

hour period. From its sales of previously acquired stock, Monitor, its principals, and others are alleged to have illegally profited by more than $600,000 in two days.

NASDR also alleges that Monitor used concerted and high-pressure sales tactics to sell a large volume of the Bulletin Board company's shares during the two-day period, including false and deceptive sales pitches and ignoring the suitability of the stock, a speculative and low-priced security with a history of operating losses, when selling it.

The complaint states that Monitor brokers were told that they would receive compensation of up to 33 percent of the sales proceeds, which would not be disclosed to investors. Customers were charged undisclosed mark-ups of at least 14 to 33 percent. NASDR generally considers mark-ups in excess of 10 percent to be fraudulent.

The complaint also states that Monitor permitted at least one unregistered individual to act as a broker. The firm is charged with lying to regulators about the use of unregistered personnel and using fictitious records to conceal their misconduct. NASD supervision rules were also allegedly violated when the firms did not have supervisory systems and procedures that would have prevented the violations.

Test Cheaters — Finally, every investor has the right to expect that his or her broker is honest and understands the securities markets and its regulations. This is a cornerstone of investor protection. To fulfill this responsibility, NASDR in August 1997, announced that it had barred, censured, and fined 20 more registered representatives suspected of paying an impostor to take a qualification exam on their behalf. More than $1.8 million in fines and forfeited commissions were assessed against these brokers. This brings to 41 the number of suspected "test cheaters" we have thrown out of the industry. NASDR has also worked closely with the Manhattan District Attorney's office in the indictments of 52 impostors and others implicated in this matter.

Recent NASD Rules and Rule Proposals

NASDR combats fraud in the microcap market not only with enforcement actions directed at specific firms and registered reps, but through effective rules as well. These rules apply to all of our members and all of their associated persons.

Clearing Firms

We have been active in enhancing the role of clearing firms in the regulation of thinly capitalized introducing firms. We are working hand in hand with both the SEC and the New York Stock Exchange to impose, through across-the-board rulemaking, new reporting responsibilities on firms that act as clearing brokers for other firms. These proposals would require clearing firms to provide information that will allow self-regulators to better monitor the activities of the firms on whose behalf they clear trades -- so called "introducing firms." Under proposals that that were approved by the NASD Board of Governors in September 1997, clearing firms will be required to report to the NASD or other Designated Examining Authority certain written complaints that they receive on activities of the introducing firm, and forward all complaints received to the introducing firm. The clearing firm will also be required to make available to its introducing firms reports and analyses of the introducing firm's own activities. That proposal has

been filed for approval with the SEC and, at the same time published for comment in NASD *Notice to Members 97-79*.

Taping Rule

When we succeed in putting a recidivist firm out of business, our job is not over. Sometimes the principals in those firms turn around and form new firms under a different name; other times the brokers go in clusters to existing broker-dealers. When a large number of these brokers become employed at another broker-dealer, this raises the risk that their new firm will have significant sales staff who may not have yet forgotten their bad habits. In September 1997, NASDR filed with the SEC a significant proposal on the taping of broker's conversations with their customers. Our new rule will require a brokerage firm to tape record all brokers calls with existing or potential customers if a certain percentage of the firm's brokers were employed by a disciplined brokerage within the last two years. The taping rule defines a disciplined firm as one that has been expelled from a securities industry self-regulatory organization, or has had its registration revoked by the SEC, for sales practice violations or telemarketing abuses. The threshold percentage of brokers from a disciplined firm that would require recording will vary from 40% for a small firm to 20% for a large firm.

Telemarketing

We have seen too many instances where investors become the unwitting victims of "cold calls" and high-pressure sales tactics. These tactics are used by certain brokers to convince an investor to purchase stock over the telephone from a broker they do not know. NASDR has responded to abuses of this type by adopting "telemarketing rules." In 1995, we adopted a "cold call" rule that requires NASD member firms to keep "do not call" lists of persons who do not wish to receive telephone solicitations from the securities firm or its brokers. More recently, we have strengthened the regulation of this area by prohibiting firms and their brokers from telephoning a noncustomer's residence to sell securities during certain times, unless they have the prior consent of the person. In addition, in making these calls, member firms and brokers must immediately give their names, the name of their firms, their telephone number or address, and state that the purpose of the call is to sell securities or related products.

Our current rules limit what unregistered personnel may say in cold calls to three questions: (1) Would you like to come to a seminar where a registered person will discuss investments? (2) Would you like some literature about the firm? and (3) Would you like to talk to a registered salesperson? Because of concerns that some firms may be using unregistered personnel to speak to prospective customers about prohibited subjects, we recently solicited comment on a proposal to require the registration of all personnel that speak to prospective customers. The comment we have received on this proposal suggests that a more effective approach may be to focus less on registration -- which may be a fairly limited tool in combating the more egregious cold calling abuses -- and to focus more on heightened supervision of the individuals making these calls, whether the individual is an employee of a member firm or is employed by a telemarketing company retained by a member firm to make cold calls. We are studying these comments to determine the most effective regulatory approach to combat abuses in this area.

Electronic Media and The Internet

The use of electronic media -- including the Internet and e-mail -- to

disseminate securities related information has grown enormously. This is an area of concern to NASDR. We will soon implement an automated system that greatly increases the range, speed, and early warning capabilities of our Internet surveillance. This prototype, named "The Internet Surveillance System" (also known as "NetWatch"), will monitor the Internet in search of individuals disseminating potentially false or misleading information about Nasdaq and OTC issues through this medium. The system will scan a list of web sites and Usenet newsgroups on a daily basis. Using advanced natural language processing tools, the system will identify references to companies and issues within the retrieved text and perform a numerical analysis on the frequency of citations to determine if an issue has an unusually high level of discussion. The staff will analyze the data that generated the notification and search through hyperlinked texts to determine if potential regulatory issues requiring further review are present. The system will also archive Internet data so that if an issuer deletes information from its home page, the analyst will be able to retrieve historical data.

In addition to enhancing our technology, we have filed proposed rule changes with the SEC that require member firms to establish written procedures for the review of electronic correspondence, which are discussed in NASD *Notice to Members 98-11*.

Nasdaq Initiatives

To ensure the continued integrity of The Nasdaq Stock Market, NASD is committed to the highest quality listing qualifications program. Although the Nasdaq SmallCap Market represents only 3.1% of the Nasdaq's total market value, it devotes considerable energy to its SmallCap qualifications program. In that regard, it has recently increased its listing standards, added significant staff, and continues to aggressively evaluate current and prospective SmallCap issuers to ensure full compliance with Nasdaq listing standards.

New Listing Standards

In August of last year the SEC approved new listing standards for Nasdaq listed companies. These standards raise financial listing requirements significantly, eliminate issuers with a bid price below $1.00, and also extend corporate governance standards to all Nasdaq listed companies. These listing standards will continue to improve the quality of smaller issuers on The Nasdaq Stock Market, and make it even more difficult for Nasdaq securities to become the target of abusive schemes.

Increased Resources

Over the last year, Nasdaq has significantly enhanced resources by increasing Listing Qualifications staff by 36 percent and has scheduled an additional 20 percent increase for this year. It has also created and staffed a new Listing Investigations Department – a group of accountants, investigators and lawyers who will proactively investigate the financial reports, business plans and other filings of companies suspected of potentially fraudulent behavior. Investigations conducted by the Department will focus on issuers that otherwise comply with Nasdaq's listing standards, but may have issued false financial statements or otherwise engaged in fraudulent conduct to become or remain listed on Nasdaq. In addition, Nasdaq is completing development of an automated risk assessment system. This system, which uses advanced computer analysis,

identifies companies with compliance profiles that suggest the need for heightened scrutiny.

Review Activities

Nasdaq continues to enforce its listing standards aggressively. In 1997, the Listing Qualifications Department denied 43 percent of applications received for listing on the Nasdaq SmallCap Market. Of these applications, 52 percent were denied based on Nasdaq's identification of public interest concerns, including problematic bridge financing and underwriter regulatory issues (e.g., Stratton Oakmont, Maidstone).

Investor Education

Investor protection initiatives through new rule proposals have been one of our highest priorities. NASDR believes that one of the most effective ways to protect individual investors is to provide them with information they need to make educated and sound investment decisions. We have coupled our initiatives with an enhanced investor education and outreach program through our Office of Individual Investor Services. This Office was launched by the NASD in August 1996 and given a mandate to help focus the attention of the organization and industry on the individual investor. Through this Office, the individual investor has a strong advocate within our organization.

The foundation of this program is the NASDR Web site (www.nasdr.com). This site provides investors a basic primer on how the regulatory process works, how investors can avoid problems before they occur, and steps they can take should they run into difficulty. The site contains an overview of NASDR's activities, information on investing wisely, timely messages on current regulatory developments, and descriptions of the arbitration and mediation process. It also allows investors the on-line ability to request disciplinary histories of brokers, file complaints, and comment on proposed rules.

Noting the importance of this information to investors, we have recently expanded the information available to investors about the disciplinary history of a member firm or an associated person on our toll free Hotline. This Hotline permits investors — without charge — to check out an individual or firm's regulatory history, including prior violations, before doing business with them. In 1997, new rules went into effect by which we now publicize disciplinary complaints at the time they are filed and non-final "trial level" decisions in cases involving designated investor protection rules and statutory provisions. As of January 1, 1998, a new rule requires that NASD members with customer accounts must inform their customers in writing, at least annually, of the Hotline number, the NASDR web site address, and the availability of a brochure on our Public Disclosure Program. In the first quarter of this year, we plan to provide the public on-line query capability, via the NASDR web-site, of broker and firm employment-related information.

Our Web site is complemented by the NASD's Individual Investor Services site (www.investor.nasd.com), which offers training on investment basics, guidance on working with a broker, market research, and a calendar of investor events. In addition, the NASD publishes an investor newsletter, makes

presentations, and provides information at investor forums. And, continuing to focus our efforts on the use of electronic media, NASDR initiated an Internet Education program. The key element of this program is a brochure distributed free to investors through the NASD and its member firms either on-line or by mail. This brochure provides guidelines for using securities information on the Internet safely.

Another way in which the NASD is trying to educate investors so that they can protect themselves are two pieces of literature that we have created titled "There are Rules to Protect You When Stockbrokers Call" And "What To Do If A Broker Calls To Pitch An IPO (Initial Public Offering)." These short pieces are designed to be distributed widely to consumers as envelope stuffers or short items in newsletters, to inform them of the requirements placed on brokers making sales calls in general or calls for an IPO in particular.

NASDR's Future Efforts

A strong regulatory response is needed to the problems in the microcap market. The NASD has already made this area a prime focus of our regulatory program, but we plan to expand our efforts even further. The NASD has actively studied this market, particularly the OTC Bulletin Board, to determine what additional rule changes and enforcement initiatives are needed to address the problems we see.

Investors need to have access to more accurate and current information about the companies whose shares are quoted on the OTC Bulletin Board. Too often the only information investors have about these issues is the misinformation and hype posted on a stock promoter's Web page or the pie-in-the-sky promises made by a brash cold-calling broker. We believe that companies that are unwilling or unable to provide full and timely disclosure of information to the public or to regulators should not be given quotation visibility on the electronic medium of the OTC Bulletin Board.

We are also acting to strengthen the tools we have to keep the shares of bogus companies from being quoted in the over-the-counter market in the first place. This can be accomplished by toughening and clarifying the rules we have to prevent broker-dealers from initiating or continuing to quote an OTC security when they do not have current reliable financial and other information about the issuer. In addition brokers should be required to disclose to their customer's specific information about these types of investments and their differences from those traded on The Nasdaq Stock Market or the exchanges.

Finally, we are becoming more proactive in educating investors on the specific and unique characteristics of the OTC equities markets. The NASD has already begun a program to educate investors about the specific characteristics of the OTC Bulletin Board, the Pink Sheets, and other quotation media. The program will describe to investors the risks associated with the OTC equities marketplace, including that certain issuers in this marketplace are not subject to listing or maintenance standards.

The NASD Board announced on December 11, 1997 that it had approved solicitation for comment on a series of proposed changes for the OTC Bulletin Board and the OTC market. The principal changes, which are subject to approval by the SEC, would enhance investor protection by significantly increasing the amount of timely and accurate information about the companies that are quoted on the Bulletin Board. They would also require brokers to take additional steps prior

to recommending or conducting a transaction in an OTC security. The NASD is now seeking comment from investors, regulators, and other groups on each of the three proposals, prior to submission to the SEC. The NASD proposals will:

- Allow only those companies that report their current financial information to the SEC, banking, or insurance regulators to be quoted on the Bulletin Board. The rule proposal will provide for a phase-in period for those securities already quoted on the OTC Bulletin Board.

- Require brokers, before they recommend a transaction in an OTC security, to review current financial statements on the company they are recommending.

- Prior to the initial purchase of an OTC security, require that every investor receive a standard disclosure statement (prepared by the NASD) emphasizing the differences between OTC securities and other market-listed securities.

In addition to these three changes, the NASD is also considering adopting additional changes, such as seeking the authority for the NASD to halt trading in Bulletin Board securities under certain circumstances, including when a foreign regulators issues a quote halt in the stock for regulatory purposes.

Thank you for the opportunity to respond to the concerns expressed in the *Business Week* article of December 15. Please do not hesitate to contact us if you need any further information on our efforts in the microcap area.

Sincerely,

Mary L. Schapiro

Mary L. Schapiro
President

cc: Frank Zarb

NASD®

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February 9, 1998

Ms. Consuela Washington
Minority Counsel
Committee on Energy and Commerce
2322 Rayburn House Office Building
Washington, D.C., 20515-6115

Dear Ms. Washington:

On January 23, 1998, NASDR President Mary Schapiro sent a letter responding to Congressman Dingell's December 12, 1997 request for a response to the December *Business Week* article titled "Ripoff! The Secret World of Chop Stocks — and How Small Investors Are Getting Fleeced."

Since we filed that letter, we have announced our order against A.S. Goldmen and Company, a case similar to those reported in our January 23 letter. Please augment our January 23 response to include the enclosed announcement of the Goldmen case.

Sincerely,

John H. Komoroske

John H. Komoroske
Director
Congressional/State Liaison

Enclosure
cc: Frank Zarb
Mary Schapiro
Elisse Walter
Barry Goldsmith
Richard Ketchum

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Press Release

National Association of Securities Dealers, Inc.
1735 K Street, NW
Washington, DC 20006-1500

For Release: Tuesday, February 3, 1998
Contact: Michael Robinson - (202) 728-8304

NASD Regulation Fines A.S. Goldmen & Co. $200,000 and Orders $1 Million-Plus in Restitution to Customers; President, Vice President, and Trader Also Sanctioned

Washington, D.C.—NASD Regulation, Inc., today ordered A.S. Goldmen & Co., Inc., to pay a $200,000 fine and more than $1 million in restitution and interest to more than 500 customers in at least 35 states.

Three of A.S. Goldmen's officials were also sanctioned. President and owner Anthony J. Marchiano was suspended from the brokerage industry in all capacities for six months, fined $50,000, and censured; Vice President Stuart E. Winkler was suspended for two years, fined $50,000, and censured; and trader Stacy Meyers was suspended for 90 days, fined $5,000, and censured. All three must retake their exams to re-enter the brokerage industry.

After an eight-day hearing, NASD Regulation's District 10 Business Conduct Committee (DBCC) found that the Iselin, N.J.-based A.S. Goldmen manipulated the price of warrants in Innovative Tech Systems Inc., received excessive underwriting compensation, charged its customers excessive mark-ups in connection with the initial after market trading of the warrants, and did not adequately supervise its staff to prevent these violations. The manipulation and the overcharging, which occurred over a four-day period from July 26 through July 29, 1994, resulted in more than $1 million in illicit profits.

NASD Regulation found no evidence that Innovative Tech Systems, which was (and still is) listed on The Nasdaq Stock Market's Small Cap Market at the time, knew that the price of its shares was being manipulated.

The abuses at A.S. Goldmen were uncovered by a lengthy NASD Regulation investigation by the Market Regulation and Enforcement Departments, and the District Offices in New York and Denver.

NASD Regulation found that A.S. Goldmen controlled the supply of Innovative Tech's warrants, through its own accounts and its customers' accounts, immediately following the company's Initial Public Offering (IPO) on July 26, 1994.

Prior to the IPO, Innovative Tech provided 1.3 million warrants to 21 bridge financiers. Within the first two hours of trading on July 26th, A.S. Goldmen purchased most of the 1.3 million warrants held by the bridge financiers below quoted prices. By adding these warrants to the almost 1.8 million remaining warrants held by the firm in its customers' accounts, A.S. Goldmen dominated and controlled the market for Innovative Tech's warrants.

A.S. Goldmen artificially increased the warrant's price to almost $2 per share, more than a 700 percent increase over the offering price. As a result, customers were charged mark-ups of 5 to 140 percent. NASD Regulation considers mark-ups in excess of 10 percent to be fraudulent.

NASD Regulation found that even though A.S. Goldmen was only one of 12 market makers in Innovative Tech, sales between the firm and its customers accounted for approximately 97 percent of all the warrants traded.

A.S. Goldmen was also found to have violated NASD rules and federal securities laws that

prohibit any firm from simultaneously bidding for and purchasing a security, while distributing it.

In addition, A.S. Goldmen received more than $750,000 in excessive underwriting compensation. NASD rules set strict limits on the permissible level of underwriters' compensation.

NASD Regulation found the following violations:

- Anthony J. Marchiano – Failed to supervise.
- Stuart E. Winkler – Engaged in manipulative trading while the firm was distributing the warrants, charged fraudulently excessive mark-ups, charged excessive underwriting compensation, and failed to supervise.
- Stacy Meyers – Charged excessive mark-ups.

Initial actions, such as this, by an NASD Regulation DBCC are final after 45 days, unless they are appealed to NASD Regulation's National Adjudicatory Council (NAC), or called for review by the NAC. The sanctions are not effective during this period. If the decision in this case is appealed or called for review, the findings may be increased, decreased, modified, or reversed.

In this case, the more than 500 investors will receive restitution payments from A.S. Goldmen within 120 days of the final decision.

NASD Regulation's DBCCs are comprised of elected representatives from the securities industry who serve three-year terms.

Investors can obtain the disciplinary record of any NASD-registered broker or brokerage firm by calling (800) 289-9999, or by sending an e-mail through NASD Regulation's Web Site (*www.nasdr.com*).

NASD Regulation oversees all U.S. stockbrokers and brokerage firms. NASD Regulation, and The Nasdaq Stock Market, Inc., are subsidiaries of the National Association of Securities Dealers, Inc. (NASD®), the largest securities-industry self-regulatory organization in the United States.

For more information on NASD Regulation, visit the Web Site (*www.nasdr.com*).

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NASAA

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February 6, 1998

The Honorable John D. Dingell
Ranking Member
Committee on Commerce
2322 Rayburn HOB
Washington, DC 20515

Dear Congressman Dingell:

Of the many issues confronting state securities regulators today, micro-cap fraud is one of our top priorities. The North American Securities Administrators Association, Inc. ("NASAA")[1] appreciates the attention you are bringing to the issue of fraud in this market segment, and thanks you for the opportunity to outline our perspective, our remedial efforts to date and our suggestions and plans for corrective measures yet to come. We look forward to working with you and the U.S. General Accounting Office to provide whatever information we have on this issue.

Micro-cap fraud is not a new problem for state regulators; in one form or another, it has plagued investors in the more speculative markets for many years. Most recently, its roots can be traced to the penny stock scams prevalent in the seventies and eighties; though in many respects, the problems in the micro-cap markets of today have grown more grave because of savings and investment patterns and market conditions.

This letter outlines what we believe to be the problem, its origins, and the states' responses. We will set forth the remedial actions states have undertaken, both individually and collectively, through NASAA, that pertain to micro-cap fraud.

THE PROBLEM

First, what do we mean by the "micro-cap" market? "Micro-cap," includes penny stocks, and generally describes the low-priced securities of small companies with market capitalizations of less than $300 million. Most of the micro-cap stocks we are concerned about are thinly-traded, risky stocks issued by start-up companies with little or no earnings. The vast majority trade on the Nasdaq Small-Cap Market, the Over-The-Counter Bulletin Board, or in the "pink sheets," a market data service previously printed daily on pink paper, and now available on electronic data feeds from private vendors.

[1] The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc., was organized in 1919. It is a voluntary association with a membership consisting of the 65 state, provincial and territorial securities administrators in the 50 states, the District of Columbia, Canada, Mexico and Puerto Rico. In the United States, NASAA is the voice of the 50 state securities agencies responsible for grass-roots investor protection and efficient capital formation.

President: Denise Voigt Crawford (Texas) • President-elect: Peter C. Hildreth (New Hampshire) • Secretary: Adrienne Wanstall (British Columbia) • Treasurer: Richard Cortese (Vermont)
Directors: Joseph P. Borg (Alabama) • Craig A. Goettsch (Iowa) • Mark J. Griffin (Utah) • Don Saxon (Florida) • Bradley W. Skolnik (Indiana)
Executive Director: Neal E. Sullivan
Ombudsman: Robert M. Lam (Pennsylvania)

Micro-cap fraud stems from the systemic employment of abusive sales practices by firms marketing low-priced and highly speculative securities over the telephone. These firms may be easily distinguished from their legitimate Wall Street counterparts by their inattention to compliance matters and their disregard for the financial welfare of their customers. NASAA's investigations revealed that in many cases the brokers of the penny stock firms of the eighties are now the head traders, principals or chief executives of the micro-cap firms of today.

Problem firms creating the fraud generate a significant percentage of their revenues by underwriting initial public offerings ("IPOs") in micro-cap stock. The IPOs they structure are often positioned to present opportunities for manipulation. Additionally, transactions in the securities in which these firms make markets are often characterized by heavy mark-ups, sometimes as high as 30%. This results in extreme transaction costs even though customers are routinely told they will not be charged commissions. Often, when customers experience a dramatic price decline and place sell orders, these orders are ignored, leaving the investor with significant losses.

Abusive and high-pressure sales practices appear to be part of the corporate culture at these firms. Long-term customer relationships are rare. Formal compliance training and substantive schooling in sound market techniques and customer service are replaced by sophisticated cold-calling methods. Scores of unlicensed solicitors, employing elaborate scripts, persistently call their prospects until they agree to invest in the micro-cap stock du jour. Often there is no expectation of servicing the account beyond that initial trade.

Lastly, though geographic location of these firms is diverse, there seems to be a concentration of these firms in the New York City metropolitan area. In sales scripts seized by state regulators and taped transcripts of actual cold-calls, the firms located in this area take every advantage of their "Wall Street" proximity, trading on the name of the Street to bolster their credibility and reputation. We have also discovered that the potential investor is lured into a false sense of comfort by the frequent use of names of well-respected and recognized Wall Street firms. In their affiliation with these micro-cap firms, the clearing firm performs nothing more than administrative services and has no supervisory responsibilities for the activities of the introducing brokers.

All the above characterizes the problem we have come to know as micro-cap fraud.

CONTRIBUTING FACTORS

We believe the fundamentals are in place for a bull market in fraud. There are several reasons. Today one in three households invests in securities. An even more telling statistic: 31% of U.S. household financial assets are invested in equities, either directly, or indirectly through mutual funds, up from 17% at the end of 1990.[2] To an extent this has helped fuel the bull market itself.[3] Of course, these waves of new market participants have, in part, fueled dramatic market performance of recent years (the Dow Jones Industrial Average doubled in two and a half years, from 4,000 in February, 1995 to 8,000 in July, 1997).

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[2] Investment Company Institute, 1997 Mutual Fund Fact Book.

[3] Annual share volume on the New York Stock Exchange ("NYSE") rose from 51 billion shares in 1992 to 121 billion shares in 1997. The Nasdaq's growth from 48 billion shares in 1992 to nearly 149 billion in 1997 was even greater. The Nasdaq small-cap market volume remained rather stable at approximately 13 billion shares.

As a practical matter this shift in savings patterns has resulted in an ever-growing number of less sophisticated investors entering the marketplace. At the same time, investors are seeking ever-increasing returns on investment without a careful analysis of the risk/reward balance. In October of 1997, Montgomery Asset Management reported results of an investor survey that found that investors expected their portfolios to produce average returns of 34% annually over the next ten years.[4] This number appears to NASAA to suggest that individual investors are placing heavy emphasis on returns at the expense of risk tolerance.

Therefore, we have parallel trends of an aggregate lower level of sophistication in the market coupled with unrealistically high expectations on return on investment. This creates the perfect environment for fraud and abuse.

What's more, millions of new individuals investing in the markets create a greater demand for salespersons. A five-year review indicates the number of representatives registered with the NASD jumped from 426,979 in 1992 to over 565,000 in 1997.[5] And it is our belief that regulatory resources have not kept pace with this growth.

RISING COMPLAINTS

In 1997, many states received an increasing number of complaints from the investing public compared to 1996 levels. State securities regulators, we should note, act as a kind of "early warning radar" tracking brokers and underwriters engaging in abusive sales tactics. NASAA finds the increasing number of complaints in certain states revealing because a burgeoning stock market with high returns generally means investors are content and refrain from logging complaints with their state regulators.

The most frequent complaints received involve high-pressure calls from brokers, brokers who refuse to sell a stock when directed, brokers who make unauthorized trades and brokers who make unsuitable recommendations. A sampling of states reporting higher numbers of investor complaints to the state securities agencies include:

STATE	1996	1997
Connecticut	219	238
Georgia	563	620
Idaho (investigations and inquiries)	565	803
Illinois	800	1221
Massachusetts	372	526
New Jersey (requests for assistance)	1527	2012
New York (inquiries and complaints)	3100	4300
Pennsylvania	111	133

[4] Montgomery Asset Management press release, October 6, 1997.

[5] Nasdaq Market Data.

STATES' RESPONSE TO COMPLAINTS

At the NASAA Annual Conference in September of 1996, these complaints became an informal topic of conversation among state regulators; it was apparent a systemic problem was developing.

Later that fall, NASAA's Board of Directors authorized a special project to address the issue of fraudulent sales practices in the micro-cap marketplace. In January of 1997, NASAA created a task force made up of representatives from 12 states. The task force was then divided into teams, each targeting a particular micro-cap firm. Branch offices and additional firms in other states were scheduled for audits as well.

In February, 1997, audit teams from these states examined five firms in the New York metropolitan area. Concurrently, other states conducted similar investigations. Ultimately 20 states participated in taking actions, with NASAA serving as the coordinator for this nationwide examination of dealers selling micro-cap stocks.

At a May 29, 1997 news conference with the New York and New Jersey Attorneys General, NASAA announced that 20 state securities agencies had filed 36 actions against 14 micro-cap firms—the largest-ever coordinated state enforcement initiative aimed at a particular market sector.

What the NASAA team found was a disturbing cottage industry of cold-callers, boiler rooms and nonexistent analyst reports used to hype micro-cap stock.

THE SWEEP UNCOVERED FOUR SYSTEMIC ABUSES:

ABUSIVE COLD-CALLING PRACTICES

All of the firms relied on high-pressure, scripted telephone cold-calling practices. Many operations were classic boiler rooms with long tables and up to seven phone stations per table. Unregistered cold-callers were found in all of the firms. The scripts seized demonstrate the nature of the problem. Here is a quote from a script used by cold-callers at Investors Associates, Inc., "Perhaps a 100% return in 20 minutes sounds a bit unrealistic, but I assure you that's exactly how all of our IPOs ("Initial Public Offerings") trade."

SALES PRACTICE ABUSES

Unauthorized trading was rampant at all the firms examined by the states. Examiners found that firm and branch records were falsified. In order to mask unregistered sales by cold-callers, customer account forms were marked with a number from a registered representative with whom investors insist they never dealt. The firms systematically failed to execute customer sell orders, made unsuitable recommendations, employed unethical high-pressure sales tactics and displayed a general disregard for the accepted role of compliance procedures which the securities industry is required to maintain. For example, at one firm all the cold-callers were on the first floor with no supervision at all.

FAILURE TO REPORT INVESTOR COMPLAINTS

State examiners found hundreds of unreported customer complaints. Most of the firms failed to maintain centralized procedures for handling and reporting customer complaints to regulators, as required by law. Unauthorized trades were so common that state examiners found fill-in-the-

blank forms these firms used to respond to customer allegations. The forms contained blanks for the stock name; its value; and the reason for the unauthorized trade. One firm had reported just one complaint to the NASD Regulation, Inc. ("NASDR") from 7/96 through 2/97 but examiners uncovered over 90 unreported complaints on site.

EVASION OF BROKER-DEALER REGISTRATION REQUIREMENTS THROUGH USE OF THIRD PARTY FRANCHISE AGREEMENTS

Brokers and firms are required to register in the states in which they transact business. This requirement is absolute unless an exemption is available. When firms are transacting unregistered business it is a sure sign of problems--including avoidance of certain record-keeping requirements relied on by state regulators to protect their citizens. Examiners found that some firms claimed their branches were "franchises" in order to evade the state supervisory and record-keeping requirements.

STATE FOLLOW THROUGH ON MICRO-CAP SWEEP

Other actions continue to follow as a result of this project. The 20 original states were joined by 13 more and, to date, have together filed 81 final actions and have an additional 11 actions pending. A complete list of the actions taken against six of the firms is included as Tab 2.

Later in the summer of 1997, The New York State Attorney General convened a series of public hearings to gather additional facts regarding the scope of this problem. The hearing panel received testimony from 27 witnesses and interviewed approximately 12 others. The following state regulators submitted written testimony and is included as Tab 3: California, Delaware, Hawaii, Illinois, Indiana, Maryland, New Hampshire, Ohio, Oklahoma, Pennsylvania, South Carolina, Tennessee, Texas, Vermont, and Washington.

The hearings showed that some micro-cap firms specifically target unsophisticated investors. The victims are often the elderly, who are more likely to be home when the phone rings, less likely to hang up, and more apt to fall prey to high-pressure telemarketing techniques.

Many of the firms targeted, employ brokers who frequently move from one micro-cap firm to another. It is not uncommon for these brokers to have a history of regulatory actions and numerous customer complaints. The hearings also found problems with unregistered cold-calling.[6]

ONGOING ROLE OF THE STATES

THE PRIMARY MISSION OF STATE REGULATORS IS TO PROTECT INDIVIDUAL INVESTORS

State securities agencies are often the first contacted when individual investors have questions or concerns. Consequently, much of our focus is placed on the individual investor. While our federal counterparts are well-equipped to focus on broad national market issues, state regulators specifically focus on the protection of individual investors.

STATE LICENSING FUNCTION SERVES TO SCREEN OUT PROBLEM BROKERS

State agencies devote an ever-increasing level of resources to the function of screening out problem brokers. This is detailed in the NASAA submission to the Securities and Exchange

[6] New York State Attorney General's Report on Micro-Cap Stock Fraud.

Commission ("SEC") in connection with a mandated study under the National Securities Markets Improvement Act of 1996[7] on the uniformity of state licensing requirements of associated persons of registered brokers and dealers[8]. The dual roles of cracking down on fraudulent brokerage houses and screening out problem brokers often go hand in hand.

OVERSEEING BOTH THE SALES PERSONNEL AND THE PRODUCTS THEY SELL IN THIS SEGMENT OF THE MARKET IS A SIGNIFICANT PART OF THE OVERALL STATE ROLE

The micro-cap stocks sold by these firms are subject to state registration and review. Unlike mutual funds and stocks trading on the AMEX, Nasdaq NMS and NYSE, these predominantly regional stock offerings must be registered in order to be offered or sold in a state. As discussed above, all the sales personnel of these micro-cap dealers also must be licensed and reviewed. Therefore, this lower tier of the market receives the greatest amount of state regulatory scrutiny.

OTHER STATE INITIATIVES

State regulators combine a variety of tools and procedures in their anti-fraud efforts, both at the front-end through licensing, review of securities offerings and other investor protection efforts and after-the-fact through enforcement actions. In addition, states are making administrative changes and restructuring their operations to more effectively target the problem of micro-cap fraud. Many states have developed model programs in these areas. The programs represent various methods and procedures that have been developed and tailored to the specific state needs and resources. The cumulative effect is a critical national framework of local regulation. What follows is a brief description of several such efforts from a few select states.

STATE LICENSING OF BROKER-DEALERS AND THEIR AGENTS

MAINE

In 1988, Maine instituted a program to increase the scrutiny of all broker-dealer applications, particularly applications where the firm or any of its owners, officers or directors had been involved with penny stock firms that had exhibited a propensity for sales practice abuses. Over the years this policy has shielded Maine investors from well-known micro-cap firms such as First Jersey Securities, Blinder Robinson, Stratton Oakmont and H. J. Meyers & Co. Maine's program includes reviewing the types of products the firm has sold in the last year, how those products are selected, who in the firm is responsible for researching the products to be sold, and the policies the firm has in place to ensure that the products are only sold to suitable investors. In addition, if the sales force is going to conduct cold-calls, the state has insisted that all callers be licensed before placing calls into Maine.

Of firms subject to the NASAA sweep last spring, Maine licensed only five of the 14 firms (see page 4). One of the remaining five was subject to a conditional licensing agreement. A revocation has been filed against another.

In 1997, Maine received 161 broker-dealer applications and received 57 requests from broker-dealer applicants to withdraw their applications. Withdrawal of an application is often a mutually agreed-upon resolution when an applicant is unacceptable. While some of the 57

[7] 104 Pub. L. No. 104-290, 110 Stat. 3416 (1996) (to be codified in various sections of 15 USC).

[8] See NASAA reports (CCH) ¶13046 (Sept. 1997).

broker-dealers that withdrew may have applied in an earlier year, the statistics have remained fairly consistent with a withdrawal rate of 25 to 35% of all broker-dealer applications filed.

COLORADO

Colorado records indicate that about 341 of the 68,644 sales representative licensing applications received by the Securities Division over the last two fiscal years (FYs 95-96 and 96-97) were withdrawn by the applicant or firm following an inquiry into reported disciplinary issues. The Division estimates that about 75% of those withdrawn applications were filed by individuals and firms involved in the "micro-cap" market.

Since Colorado enhanced its securities registration disclosure requirements and added escrow requirements for "blank check" offerings in 1990, the state has fought an ongoing battle with penny stock and "blank check" promoters. The offering documents describe what purport to be a real business, but in reality these entities are nothing more than empty shells designed to provide a vehicle to the public markets which is easily manipulated.

In summary, much of the regulatory effort exerted in Colorado against old and new penny stock operators, now dubbed "micro-cap" operators, is very difficult to quantify. However, the practical result has been that the combined efforts of federal, state and self-regulatory organizations has led to a very real reduction in the fraudulent activities that gave Colorado such a bad reputation in the 1970s and 1980s.

FLORIDA

The Florida Division of Securities has been successful in curtailing the amount of micro-cap fraud in the state by implementing effective registration and examination programs. The Division routinely denies individuals with significant disciplinary histories, whether they are in this segment of the market or associated with New York Stock Exchange members. The information needed to deny or revoke these licenses is obtained during the course of examinations conducted on firms and individuals operating in, to, or from the State of Florida. The examination program, implemented by the Division's Regulatory Support Section, maintains a close working relationship with the registration staff in facilitating the active review of pending registrations of both individuals and firms in the state. The Division resolves concerns relating to customer complaints and registration and sales practices prior to rendering a decision on an application.

The Division also maintains close liaison with other states and with the NASDR, and the SEC regional and national offices. This exchange of "intelligence" on the movement of individuals from one firm to another and the exchange of examination documents is essential to the successful implementation of the program.

The Thomas James Associates, Inc. ("Thomas James") case exemplifies Florida's examination program. Thomas James had two branch offices in Florida on which the Division of Securities performed on-site examinations. The examinations uncovered many firm-wide unsavory practices that culminated in the Division taking action. In April, 1990, the State of Florida Department of Banking and Finance, the parent state office of the Florida Division of Securities, instituted an administrative complaint against Thomas James Associates, Inc. and 31 of the firm's registered representatives, including its principals, control persons and treasurer, which sought to revoke the firm's license and suspend many of its agents. Among other things, the

complaint alleged market manipulation; non-disclosure of material facts; unregistered agent activity; lax supervision; and not executing customer requests to sell securities.

The filing of the complaint led Thomas James to enter into a consent order with the Department of Banking and Finance. As a result of the order, the firm was forced to withdraw its broker-dealer license from Florida and agree not to reapply for registration prior to June, 1994. Various sanctions were levied against the firm's agents as well, including, most prominently, barring James' President/control person and Treasurer from registering until June, 1994 and barring the Florida branch officer managers from registering in the state for several years. Their re-licensing is predicated upon entering into a conditional registration agreement which mandates that they do not act as supervisory personnel and, in fact, receive special supervision themselves.

SOUTH CAROLINA

Rather than allowing questionable brokers to register and then wait until constituents are harmed, in 1997, South Carolina recently implemented a proactive, two-step plan to prevent broker-dealer agents with significant disciplinary problems from registering in the state.

In the first phase, all applicants for registration are screened for disciplinary occurrences via the Central Registration Depository ("CRD") database. Those applicants with three or more disciplinary occurrences are automatically sent a letter asking for a signed, sworn and notarized explanation of these incidents, as well as verification that they have no clients in South Carolina. Approximately 40% of the applicants withdraw their applications upon receipt of this letter. This "step" serves two purposes. It affords fairness and due process to the applicants, who are provided ample opportunity to tell "their side of the story," while providing an efficient screening mechanism for regulators.

The second phase is to verify that the withdrawn or denied applicants are not transacting securities business with South Carolinians. The Securities Division contacts the broker-dealers' clearing firms for account activity reports and then ascertains whether or not unregistered agents effected any transactions in the state. If the withdrawn agents engaged in such transactions, the Securities Division may send a cease and desist letter to the agent and his or her firm, or revoke the entire firm's registration and levy a fine of up to $5,000 per occurrence.

South Carolina also protects investors by using other states' revocations as grounds for revoking a broker-dealer's registration in South Carolina. For example, on January 21, 1998, South Carolina revoked the registration of Meyers, Pollock, Robbins on the basis of both Massachusetts' and Indiana's revocations.

SUBSTANTIVE REVIEW OF STOCK OFFERINGS

The Pennsylvania Securities Commission ("PSC") prepared a report on the corporate finance authority exercisable at the state level. The report analyzed the 112 filings with the PSC in Fiscal Year 1996.[9] The report is representative of the type of front-end protection afforded by those states exercising substantive review. The offerings are frequently given a rigorous vetting by state examiners due to apparent conflicts of interest and potential abuses.

[9] Pennsylvania Securities Commission, Division of Corporation Finance, Report on Corporate Equity Offerings Filed under Section 205 of the Pennsylvania Securities Act of 1972, July 1, 1995 – June 30, 1996, dated January 29, 1997.

Examples of state substantive review include escrows of cheap stock held by company insiders, limitations on options and warrants granted, and ceilings placed on the offering expenses.

Meeting these state regulatory requirements defeats the primary mechanisms of unfair and inequitable offerings and helps to keep these IPOs from being sold to the investing public. Of the sixteen IPOs identified in the December 12, 1997 *Business Week* article, "The Mob on Wall Street," only eight were filed with the PSC. Of those eight, six were withdrawn as a result of PSC comments.

Recent changes in federal law have created an incentive for issuers to avoid initial registration in certain states, only to sell into those states in the secondary market shortly after trading commences in the IPO shares.

OTHER HIGHLIGHTS FROM THE REPORT (ANALYSIS OF 112 FILINGS WITH PSC):

Almost one-third of the offered shares (32%) were offered at a price below $5 and another 33% offered between $5.00 and $5.99.

Forty-four percent of the offerings included an accountant's "going concern" letter in which the auditor's letter expressed concerns about the issuer's ability to continue as a "going concern."

Over 75% of the offerings had losses for the most recent fiscal year.

In over 40% of the offerings, the company's promoters, officers and directors paid $.01 or less per share for their stock.

Over 45% of all underwritten offerings subject to state review were underwritten by firms with three or more incidents recorded on the CRD within the past six years.

Five firms acting as such underwriters in PSC filings were cited in the December 12, 1996 *Business Week* article, "The Mob on Wall Street."

SUMMARY OF PSC DATA

Total offerings filed	112
Offerings held for issuer response or withdrawn	75
OFFERINGS REGISTERED	**37**

As you can see, by placing substantive review criteria and resources up-front, the PSC was able to focus on the offerings with structural flaws or those potentially designed to enrich a few insiders at the expense of individual investors.

ENFORCEMENT EXAMPLES

STRATTON OAKMONT, INC.

In 1995, with the organizational support of NASAA, Alabama undertook the lead role in a multi-state investigation of the broker-dealer firm Stratton Oakmont, Inc. ("Stratton") which had its headquarters in New York State. Investigators and examiners from Alabama, Kansas, Pennsylvania, Illinois, Colorado, New Mexico, Arizona, Mississippi and Georgia, with assistance from other states, joined together in this massive investigation of the acts, practices and transactions of Stratton and its agents. This thorough investigation consumed nearly two

years, and half-a-million dollars in time and expenses to complete. As a result of this investigation, over 20 states brought actions against the firm.

The multi-state Stratton investigation presented a case study in the operations of a micro-cap fraud. Analysis of the web of financial dealings detailed how Stratton manipulated the offering to shift control of the IPO shares into the hands of a few insiders. In addition, the careers of the brokers, traders and principals were tracked to detail how the same individuals moved from one micro-cap firm to another over a period of at least twelve years.[10]

HANOVER STERLING & CO.

Hanover Sterling & Co. is another example of the states initiating actions against a firm which eventually found its NASD membership cancelled.

Beginning in October, 1993, Idaho was the first to take action against Hanover Sterling & Co., for selling into the state with unregistered agents. In June, 1994, Kansas denied Hanover Sterling & Co.'s registration. The following year, 1995, both Kansas and West Virginia brought actions against the firm for unregistered activities in their respective states. Later that year, Hanover Sterling & Co.'s broker-dealer registration was revoked or cancelled by Massachusetts, Illinois, California, Texas, and Oklahoma. Eventually, 29 states terminated the firm.

While states cannot put firms out of business nationally, they can doggedly pursue these firms until the NASD and the SEC act at the national level.

THE FOCUS ON CLEARING FIRMS

As noted earlier, state regulators have seen significant numbers of investor complaints regarding micro-cap firms and brokers. The majority of these micro-cap firms are introducing brokers and use the services of "big name" Wall Street firms to process their trades and provide their customers with account statements, confirmations and other documentation.

The number of these clearing firms is less than 800 while the number of introducing brokers is well over 5,000. Therefore, by accessing information on targeted micro-cap firms from the clearing firms, state investigations can move more rapidly and efficiently.

Given these numbers and the unique nature of the clearing business, clearing firms are in possession of information that can greatly aid the state discovery and investigations of micro-cap firms. The clearing firm as an access point is a tremendously efficient tool for the states, one that will be used increasingly in the future.

Below are just some of the abuses that clearing firm reports can assist in detecting:

Sell orders in unregistered securities;

Churning;

Patterns of unauthorized trades;

Excessive commissions; and

Detection of manipulative trading practices.

[10] See testimony of Joseph P. Borg, Director Alabama Securities Commission, before the Permanent Subcommittee on Investigations, U.S. Senate, September 22, 1997. Testimony is behind Tab 4.

In mid-January of this year examiners from the states of Utah and Missouri visited the offices of two major clearing firms in New York City. At first, the states encountered resistance to their requests, for production of customer complaints. Production was achieved only after regulatory demand letters were issued. Utah and Missouri are currently studying the results of these clearing firm examinations; however, the examinations have already confirmed that clearing firm records provide a wealth of useful information concerning the operations of introducing micro-cap brokers. Because dozens of the micro-cap firms may clear through a single clearing firm, it can result in "one-stop shopping" for regulators.

STATES RESTRUCTURING OPERATIONS TO FIGHT MICRO-CAP FRAUD

MICHIGAN – By early 1997 Michigan's enforcement staff, which audits and investigates brokerage firms, sales agents and investment advisers, had reached an all-time low of three investigators and one supervisor. Recent hires have doubled that number. Michigan has increased the number of inspections and revised audit procedures to include review of products being sold or promoted via the Internet.

The Securities and Land Development Bureau is participating in a task force (Senior Exploitation Quick Response Team) comprised of government agencies and industry representatives to address the problem of financial exploitation of senior citizens. Task force members act as contacts for their agency when a complaint comes in. The idea is to cut through the normal bureaucracy and give special expedited treatment to complaints concerning seniors, who are especially vulnerable.

The increased staff is already producing results. In January 1998, Michigan issued three orders to show cause, which involve allegations of the sale of unregistered and nonexempt securities (almost $3 million in one case).

OHIO – Micro-cap and penny stock dealers proliferated in Ohio in the late 1980s and early 1990s. In 1993, the *Dayton Daily News* estimated that approximately 60,000 Ohioans had lost more than $100 million in penny stock investments between 1989 and 1993. Beginning in 1991, the Ohio Division of Securities devoted a majority of its resources to a two-pronged effort to eradicate low-priced stock fraud in the state.

In the spring of 1991, the Division commenced legislative efforts to strengthen the dealer licensing requirements and anti-fraud standards of the Ohio Securities Act. A similar measure was re-introduced in the Ohio General Assembly in 1993 without opposition. The Bill became law on October 11, 1994. The law tightened dealer licensing requirements and added specific anti-fraud and disclosure requirements for penny stocks.

A vigorous enforcement program was commenced in Ohio with the revocation of the licenses of AEI Group, Inc., Liberty First Securities and First Ohio Equities. The Division's highest-profile enforcement action began in October, 1992 with the execution of a search warrant at the home office of Dublin Securities, Inc., the state's largest penny stock micro-cap dealer. The search warrant uncovered evidence that led a state grand jury to return a 1,023 felony count criminal indictment against two entities and five individuals. The three defendants who chose to stand trial were convicted of a total of 152 felony counts in December, 1995.

The Ohio Division of Securities pursued both legislative initiatives and enforcement actions to fight the problem of micro-cap fraud. The drastic reduction in number of complaints received by the Division gives an indication that the Division's efforts have been successful.

OHIO INVESTOR COMPLAINTS

YEAR	# OF COMPLAINTS
1992	542
1993	1385
1994	494
1995	258
1996	241
1997	223

ILLINOIS - In February, 1997, the Illinois Director of Securities proposed to the Secretary of State that the Securities Department reorganize to more appropriately meet the challenges of technology, globalization and the National Securities Markets Improvement Act of 1996. The primary objective was to reallocate existing Department resources and recognize the functional interrelationships in the Department, cross-train employees for multiple tasks and begin to shift away from office-based registration activities and move toward field-based activities such as compliance inspections, audits and investigations. The highlights of the reorganization plan include:

A new "Audit & Compliance" Division responsible for conducting and coordinating all field examination programs for Illinois registrants. The Audit Section will conduct all for-cause audits, while a new Compliance Inspection Section will coordinate all Department personnel involved in compliance examinations. The Department intends to increase the number of compliance examinations completed each year to 1,000 or more (at least six times the current level).

The Registration Division was divided and renamed "Registration & Licensing." A Small Business Information Center will be highlighted to provide assistance to legitimate small businesses.

Streamlined Department management from 14 to 6 positions.

Established a dedicated Investor Education position within the Director's office.

THE ROLE OF NASAA

In addition to the individual states, the NASAA organization has focused on the issue of micro-cap fraud and has served as a coordinator and clearinghouse for many of these efforts.

NASAA ENFORCEMENT SECTION

The NASAA Enforcement Section has 36 members serving on five committees that cover the major enforcement areas. They are Enforcement Databases; Enforcement Policy and Zones; Enforcement Training Programs; International; and Internet.

ENFORCEMENT DATABASE COMMITTEE – Educates NASAA members on the use and benefits of the Securities Investigations Database ("SID"). Monitors and evaluates SID system performance and recommends changes, additions and upgrades to the system operator. SID currently offers

two main features a securities investigation database and specific newsgroups to facilitate communication between securities enforcement personnel.

ENFORCEMENT POLICY AND ZONES COMMITTEE – Acts as a forum to develop enforcement policy and to coordinate investigations by state securities regulators by identifying trends and priorities, developing investigative approaches and enforcement remedies and collecting and maintaining information concerning enforcement cases and resources. This committee encourages and develops regional cooperation among state, provincial and federal regulators by organizing zone meetings within the regions and by acting as a conduit for communications on enforcement matters.

INTERNATIONAL COMMITTEE – Coordinates the exchange of information with international securities regulators regarding regulation of broker-dealers, enforcement and licensing guidelines.

INTERNET COMMITTEE – Coordinates the work on the development of a timely, efficient, and cost-effective means of policing the Internet for state securities law violations by issuers, broker-dealers, investment advisers and their agents or representatives and to develop a means to record and report such violations to members and investors.

NASAA BROKER-DEALER SECTION

The NASAA Broker-Dealer Section has 20 members serving on four committees that cover the areas of broker-dealer regulation. They are Broker-Dealer Operations, Broker-Dealer Sales Practices, Continuing Education and Forms Revision and Central Registration Depository.

BROKER-DEALER OPERATIONS COMMITTEE – Develops and helps implement state policies regarding broker-dealer operations, such as developing a model definition of "branch office" and updating the broker-dealer examination module as needed. This committee is also responsible for studying the use of affidavits to uncover pre-licensed sales activities by both broker-dealers and agents and, if appropriate, draft a policy statement on this issue. The Broker-Dealer Sales Practices Committee also assists in the planning and conducting of NASAA's Broker-Dealer Training Seminar. Finally, this committee will study the feasibility of member jurisdictions issuing a multi-state license where the applicant has a clean disciplinary record.

BROKER-DEALER SALES PRACTICES – Broker-dealer sales practices are often at the heart of abuses in the micro-cap area. This long-standing committee is charged with reviewing, analyzing and proposing NASAA policies associated with marketplace developments for the delivery of broker-dealer services. Potential areas of policy development include access payments, revenue sharing, commission sharing and referral fee arrangements, soft dollar compensation and utilization and standardization of performance data reporting. This committee is also responsible for developing programs for improving the effectiveness of state broker-dealer sales practice regulation generally.

CONTINUING EDUCATION – The joint efforts of NASAA and the SROs have made the continuing education program for registered representatives a marked success. NASAA is firmly committed to this cooperative undertaking. This committee makes recommendations to the membership and the Industry/Regulatory Council regarding any changes to the Continuing Education Program ("the Program") as developed, and provides representative "subject matter experts" to develop

and refine Program questions. This committee also coordinates with the SEC and SROs in developing examination procedures, modules and training.

TRAINING PROGRAMS

Starting in the 1980s, NASAA has invested a considerable amount of time and resources on training programs and conferences devoted to enforcement, litigation and examination issues. These programs have resulted in the development and publication of a NASAA broker-dealer examiners manual and an enforcement training manual utilized by all the state agencies. These sessions and materials are made available to administrators, examiners, attorneys, investigators and other state personnel at no cost to state governments.

The Winter Enforcement Conference is an annual event sponsored by NASAA and attended by securities regulators of the States, Canadian Provinces and Territories, members of academia, and federal government officials. This meeting provides a venue for regulators to formulate, recommend and implement enforcement policy.

Since 1985, NASAA has sponsored a three-track broker-dealer training program designed for broker-dealer examiners. Track I is for new examiners and contains a basic overview of the examination process, including books and records, the federal 1933 and 1934 Acts, and examination procedures. Tracks II and III are for more experienced staff and cover such topics as: update on NASD and SEC structure; Internet sites; newsletters; enforcement roundtable; soft dollar payment abuses; and Plain-English prospectuses.

The Attorney/Investigator Training Session is designed for attorneys and investigators involved primarily in enforcement of the securities laws. The agenda includes special sessions for new personnel to introduce them to basic concepts and methods in securities law enforcement. Part of the training involves separating the group into working sessions to solve hypothetical enforcement problems drawn from actual cases.

The Investment Adviser Workshop is an interactive session designed specifically for examiners. Faculty focus short presentations on issues such as custody, discretion, marketing, compensation, disclosure and practice management critical to examiners during an inspection of an investment adviser. Presentations are followed by a "breakout" into small groups led by an experienced examiner to review the books and records of a fictitious (but typical) state-registered investment adviser. Other sessions allow the small groups to conduct "mock" audits of another (more problematic) fictitious adviser.

Litigation Training draws panelists from a broad cross-section of the securities regulatory community and addresses numerous current topics relating to securities enforcement litigation. The goal of this seminar is to assist enforcement personnel in the development of effective securities litigation skills, including criminal prosecution.

INVESTOR ALERTS/BROCHURES

NASAA regularly issues "Investor Alerts" that identify common types of schemes, scams and frauds about which investors and entrepreneurs need to know. Many of the alerts can be found on the NASAA website at www.nasaa.org under the Investor Education link. NASAA distributes brochures on these same subjects at town hall meetings and other investor education forums throughout the nation. NASAA and the Council for Better Business Bureaus have

recently re-published a book based largely on these Investor Alerts entitled *How to Be an Informed Investor.*

CRD REDESIGN

State regulators rely heavily on broker-dealer and agent information contained in the Central Registration Depository (CRD), jointly owned by the states and the NASD. This database was set up in 1981 primarily as a registration tool. It contains administrative information about broker-dealers and their agents as well as customer complaints, arbitrations and other disciplinary information. State regulators have been working closely with the NASD for the past seven years on a comprehensive redesign of the CRD that will allow it to be data fields to be "searchable" by regulators. This capability will allow states to flag problem brokers and firms for further investigation, license review or revocation. The modernized CRD, when it comes on line, will be a significant step forward for state regulators in their battle against micro-cap fraud.

FURTHER MICRO-CAP EFFORTS BY STATE REGULATORS

REGULATORY MICRO-CAP WORKING GROUP – NASAA is a member of the Regulatory Micro-cap Working Group designed to better coordinate enforcement efforts and facilitate exchange of information among the SEC, NASDR and the NYSE. Discussions will focus on preventive measures to address the micro-cap fraud problem. Several meetings are planned for the coming months.

ONGOING STATE SWEEPS – Plans for the current year include continued coordinated examinations of targeted micro-cap firms. It is anticipated that a second sweep, similar to the successful effort of 1997, will be undertaken during the first quarter of 1998.

COORDINATED REGULATORY TRAINING – The AMEX, CBOE, NASAA, NASDR, NYSE and the SEC are jointly sponsoring a training conference for securities examiners focused on the detection and examination of micro-cap fraud. The training will be developed and targeted for securities examiners with two to five years of experience. We believe it is essential to ensure that examiners are well-trained and knowledgeable with respect to current examination techniques and strategies most effective in detecting micro-cap fraud. This program complements the annual NASAA Broker-Dealer Training held in June.

IMPLEMENTATION OF NEW YORK ATTORNEY GENERAL'S REPORT ON MICRO-CAP STOCK FRAUD

As a result of the widespread and increasing number of complaints about fraudulent practices in the micro-cap area of the brokerage industry, The New York Attorney General's Office has dramatically increased the number of investigations and enforcement actions over the past two years and has submitted legislative recommendations to assist the office in combating securities fraud. Chief among the legislative recommendations of the New York Attorney General's Report (Tab 5) is the statutory authority for routine examinations and inspections of broker-dealer firms and their branch offices. Highlights of the other recommendations include administrative cease & desist authority, reciprocal subpoena authority, and enhanced licensing authority over securities professionals.

CONCLUSION

The problems in the micro-cap market are serious and growing. They should not be minimized because they are limited to a relatively small sector of the marketplace. The fraud and abuse in this market can cause catastrophic losses to individual investors and, if this problem is not

vigorously addressed, it could erode the confidence in the overall securities marketplace. Unchecked, micro-cap fraud will harm not only investors but legitimate entrepreneurs who rely on equity capital to establish and grow their businesses.

State regulators play a vital role – a role that complements that of the SEC and the self-regulatory organizations – in policing our securities markets. The states are committed to working together with regulators and industry to curb the abuses in the micro-cap area. It will take coordinated action. As this letter makes clear, we have made progress, yet much more remains to be done. In order to reinforce the projects and initiatives we've already taken, NASAA recommends the following:

- State and Federal enforcement actions filed against micro-cap firms should include actions against individual brokers and where appropriate the principals of the firm. This would make it more difficult for these individuals to stay in the securities business or to transfer to other firms.
- Sanctions must be commensurate with the harm caused. Mandatory fines without regulatory sanctions such as suspensions and revocations can be factored into the cost of operating a fraudulent investment scheme. In addition, criminal sanctions should be applied where the law allows (i.e., Texas - 1997: 116 convictions from indictments involving 69 transactions, and 1996: 60 convictions from indictments involving 102 transactions).
- SEC/NASDR recognition of state enforcement actions under Section 3(a)(30) of the '34 Act, which establishes "statutory disqualifications" that the SEC and SROs may consider with respect to revoking, suspending or denying registration to broker-dealers and their agents. The section does not specifically reference state securities actions as a statutory disqualification. Currently, the SEC and the NASDR bring their own complaints concurrently or subsequent to state actions, which can create duplication of efforts and unnecessarily drain the finite pool of enforcement resources (see Borg Testimony Tab 4, pages 12-13).
- Much more needs to be done on the investor education front. The disclosure-based system of regulation relies on the fact that if investors are well informed, they will make sound investment decisions. All investor education programs should include information on how to protect against fraud.

Thank you for the opportunity to address the important issues raised in your letter. Please do not hesitate to contact Neal E. Sullivan, NASAA Executive Director, if you need additional information, or if we may assist your study in any way.

Sincerely,

Denise Voigt Crawford

Denise Voigt Crawford
NASAA President

U.S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General *Washington, D.C. 20530*

February 9, 1998

The Honorable John Dingell
Ranking Minority Member
Committee on Commerce
U.S. House of Representatives
Washington, DC 20515

Dear Congressman Dingell:

This responds to your letter to the Attorney General concerning recent media reports about so-called chop stock schemes. In the typical chop stock scheme, investors are defrauded through purchases of stock issued by micro cap (thinly capitalized) companies and sold by securities firms that obtain the stock at a small fraction of the price ultimately paid by victim investors.

Your letter indicates that you have also written to the Securities and Exchange Commission (SEC) and the National Association of Securities Dealers (NASD). As the primary regulatory and self-regulatory authorities, respectively, they are uniquely qualified to offer an assessment of the chop stock problem.

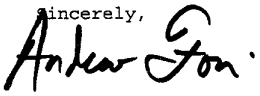
The Department has responded forcefully to the abuses associated with chop stock schemes. In recent weeks, United States Attorneys' Offices in five districts have brought charges related to micro cap schemes. On January 12, a New York City stockbroker became the fifth defendant to plead guilty to criminal charges in a micro cap stock fraud case prosecuted in the Eastern District of Virginia and the District of Nevada. Cases brought late last year include charges in the Eastern District of New York against eighteen individuals in two micro cap market manipulation schemes, a similar case in the District of New Jersey and an indictment of nineteen defendants in the Southern District of New York on racketeering and securities fraud charges. Another thirty-seven defendants, including brokers, stock promoters and issuers, have been indicted in the Southern District of New York for paying bribes to promote the sale of micro cap stocks to investors.

In addition to these cases, the Department has conducted over the past two years its Rogue Broker initiative, a nationwide series of prosecutions directed against unscrupulous brokers who prey upon unsuspecting investors. Last May, the Attorney General announced a second wave of Rogue Broker prosecutions against a total of seventeen brokers who had cheated their customers.

We view the chop stock schemes as a fusion of various abuses in the securities industry that the Department is aggressively investigating and prosecuting, sometimes as wide-ranging micro cap-related schemes and other times as more tightly focused market manipulation, broker bribery, and offering misrepresentations prosecutions. We thus believe that our enforcement efforts are responding effectively to these and other criminal schemes that victimize investors and threaten the integrity of our securities markets.

Thank you for your interest in the Department's securities fraud enforcement program. Please do not hesitate to contact the Department if we can be of further assistance with regard to this or any other matter.

Sincerely,



Andrew Fois
Assistant Attorney General

cc: The Honorable Thomas J. Bliley, Jr.
Chairman

The Honorable Michael G. Oxley
Chairman
Subcommittee on Finance and Hazardous Materials

The Honorable Thomas J. Manton
Ranking Minority Member
Subcommittee on Finance and Hazardous Materials

THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

February 9, 1998

The Honorable John D. Dingell
Ranking Member
Committee on Commerce
U.S. House of Representatives
2322 Rayburn House Office Building
Washington, D.C. 20549

Dear Congressman Dingell:

This is in response to your letter of December 12, 1997.

Like you, I view as unacceptable the possibility that any segment of this nation's securities markets has become rife with fraud and abuse. Protecting investors and combating fraud will always be at the core of the Securities and Exchange Commission's work. That is especially true for fraudulent conduct that is specifically designed and targeted at this country's growing population of vulnerable and inexperienced investors. American securities markets are the envy of the world because they are honest, fair and successful. Every member of the SEC staff is committed to using all the tools at our disposal to keep them that way.

Attached to your letter was a copy of a story that appeared in the December 15th issue of Business Week. In the wake of that article, you asked us to report on three specific issues. The first was to evaluate the extent of the so-called micro-cap fraud problem. The second was to describe the Commission's ongoing efforts to address this type of fraud. The third was to set forth our future plans to try to prevent such frauds from emerging.

The staff has prepared a memorandum that outlines our ongoing effort to respond to each of these questions. As you will see, we are making every effort to swiftly and forcefully address every issue that arises in connection with these fraudulent and abusive schemes. That is true regardless of whether these fraudulent practices involve "micro-cap" securities, "chop stocks," "penny stocks," or something else. I have called upon senior SEC staff members from every relevant office and division and given them a straightforward mandate: to develop short and long term plans to prevent such schemes from developing and, if such schemes proceed anyway, to promptly detect and vigorously prosecute them.

As outlined in the memorandum, some of our efforts are already bearing fruit. As you know, Commission staff have conducted numerous surprise inspections of small broker-dealers that had been subject to a disproportionate number of investor complaints. Our examination and inspection team has been provided special training and taught specific new procedures to help insure that documents and other materials are not improperly concealed or destroyed during an inspection.

A critical component of our prevention strategy will, of course, be based on vigorous new efforts to promote investor awareness of these schemes, and simple but effective steps investors can take to protect themselves. We are in the midst of distributing nationwide a new brochure on the dangers of "cold-calling" practices. We are also investing considerable effort into the upcoming National Investor Education Week, which will involve town hall meetings around the country to review the basics of becoming an informed investor.

Similarly, one of the most important investor education and fraud prevention tools ever devised will soon become more widely available. Starting in about a month, the first phase of the NASD's redesigned stockbroker database will become accessible over the World Wide Web. When fully implemented by mid 1999, this service will present in a user-friendly way the disciplinary and employment background for every registered broker and every registered firm in the United States. I saw a preview two weeks ago, and I am not aware of anything remotely comparable to it for any other profession in the country. It gives every investor the power to be the first line of defense against fraud and abuse by unscrupulous brokers and disreputable firms.

These are just a few of the enforcement and investment education elements of our overall effort that have already been put in place to combat so-called micro-cap fraud. A third part of this strategy -- our regulatory approach -- is being announced this week. By proposing carefully tailored new rules and regulations and targeted modifications to existing ones, the SEC hopes to reduce the ability of scam artists to manipulate procedures that were designed to reduce burdens on small businesses and to facilitate capital formation. The changes and modifications we will be considering initially are described in the attached memorandum. We will keep you apprised as we undertake additional regulatory initiatives.

The Commission recognizes your long-standing concern and leadership in promoting the integrity of American financial markets and the protection of this nation's investors. Like you, I believe that it is critical that the SEC, other federal and state regulators, the self-regulatory organizations, and industry leaders and investor advocates, aggressively combat this egregious form of securities fraud. I look forward to working with you as we continue our effort to promote integrity and confidence in this critical area of the market.

Sincerely,

Arthur Levitt

Attachment

cc: The Honorable Thomas Bliley, Jr.
The Honorable Thomas Manton
Ms. Mary Schapiro
The Honorable Michael Oxley
The Honorable Janet Reno
Ms. Denise Voigt Crawford

MEMORANDUM

TO: **Chairman Levitt**

FROM: **William McLucas**, Director, Division of Enforcement
Lori Richards, Director, Office of Compliance, Inspections and Examinations
Nancy Smith, Director, Office of Investor Education and Assistance
Brian Lane, Director, Division of Corporation Finance
Richard Lindsey, Director, Division of Market Regulation

RE: **Status of Microcap Fraud**

DATE: **February 6, 1998**

In response to your request, we discuss below microcap fraud in the securities markets. Specifically, we address in this memorandum the extent of the microcap problem, what the SEC has done to combat it, and the SEC's future plans.

1. The Extent of the Microcap Problem

A. Definition of a Microcap Company

The term "microcap security" is not defined under the federal securities laws. Issuers of microcap securities typically are thinly capitalized and they often are not required to file periodic reports with the SEC. Securities of microcap companies may be quoted over-the-counter on the "OTC" Bulletin Board operated by the National Association of Securities Dealers, Inc., (NASD) in the Pink Sheets operated by the National Quotation Bureau, and on the Nasdaq Small Cap Market. In any of these trading mediums, public information is limited and a small number of broker-dealers controls the market.

B. Quantifying the Problem

It is impossible to quantify the exact amount of microcap fraud being perpetrated. While press accounts have reported a variety of estimates, these numbers are derived generally from anecdotal evidence and rough projections.

Our enforcement efforts clearly indicate an increase in microcap fraud involving millions of dollars of direct investor losses. These losses result from trading in companies that turn out to be worthless, and commissions and fees paid by investors to brokers peddling these securities. Furthermore, the opportunities lost by investors who could have made legitimate investments in the market are incalculable.

Two market developments have led to an increase in microcap fraud. The first is the extraordinary bull market over the last decade that has captured the public's attentions, especially over the last three years. In 1996, the Dow broke 6,000, then 7,000, and this past year broke 8,000. Daily volume on the New York Stock Exchange (NYSE) and Nasdaq is also at an all-time high, and there have been record numbers of initial public offering these past several years. The second development, not surprising given the bull market, is the record level of public participation in our securities markets. Mutual fund assets ($135 million in 1980) have grown to $3.7 trillion, surpassing the $2.6 trillion that Americans have on deposit at commercial banks. As recently as 1980, only one in 16 households invested in mutual funds; today that number is more than one in three. America has evolved from a nation of savers into a nation of investors.

C. The Type of Fraud Involved

Though we cannot quantify the amount of microcap fraud that exists, we can identify how it takes place and, therefore, can work to combat it effectively. Microcap fraud typically takes one of two forms. The first -- the "pump and dump" scheme -- often involves fraudulent sales practices, including high pressure tactics from "boiler room" operations where a small army of sales personnel cold calls potential investors using scripts to induce them to purchase "house stocks" -- stocks in which the firm makes a market or has a large inventory. Investors often receive information that, at best, is exaggerated and at worst completely fabricated. Increasingly, these stocks also are touted on the Internet by unregistered promoters. The promoters of these companies, and often company insiders, typically hold large amounts of stock and make substantial profits when the stock price rises following intense promotional efforts. Once the price rises, the promoters, insiders and brokers sell, realizing their profits. Eventually, the promoters cease their manipulative promotional efforts, the stock price plummets and innocent investors incur large losses, or lose their initial investments entirely.

Second, as part of the "pump and dump," unscrupulous brokers often employ a variety of fraudulent sales practices including "bait and switch" tactics, unauthorized trading, "no net sales" policies (where investors are discouraged or actually prevented from selling their stocks) and churning (excessive trading in their accounts in order to generate commissions for the broker). The firm often charges excessive, undisclosed markups and issues arbitrary stock quotations. Even if investors complain to the brokerage firm, it rarely disciplines its registered representative or reports the investor complaints.

2. WHAT THE SEC HAS DONE TO COMBAT MICROCAP FRAUD

The SEC has combated microcap fraud through enforcement, examinations and investor education. The details of the SEC's efforts in each of these areas are discussed below.

A. Enforcement Efforts

The SEC has dedicated an increasing amount of enforcement resources to bring actions against fraudulent microcap companies, promoters and brokers. We have moved quickly by seeking immediate relief, such as temporary restraining orders and asset freezes, and imposing strong remedies such as permanent industry bars, registration revocations and fines. To minimize investor losses in ongoing market manipulation cases, we have increased our use of trading suspensions when there is misinformation about the issuer in the market. In many cases the SEC has leveraged its resources by working closely with the criminal authorities. In the cases described below, the SEC has assigned staff to work on the parallel criminal investigations. Our close work with the criminal authorities is an essential component of our enforcement program, given that a large number of repeat violators - with little respect for civil proceedings - engage in microcap fraud.

Some of the most recent efforts by the Enforcement Division include the following:

- **December 18, 1997 -- Fifty-eight individuals charged in five SEC enforcement actions:** The SEC filed five civil injunctive actions charging fifty-eight defendants with manipulation of the over-the-counter markets for microcap securities issued by Securitek International Inc., Golf Communities of America, Inc., f.k.a. Golf Ventures, Inc., Interactive Information Solutions, Inc., StockNet, Inc., International Investment Group, Ltd., Spacelex Amusement Centers International Ltd., Inc., and America's Coffee Cup., Inc.. The five actions were the result of an undercover investigation into illegal practices in the OTC securities markets conducted by the United States Attorney's Office for the Southern District of New York and the Federal Bureau of Investigation, with assistance from the SEC and the National Association of Securities Dealers Regulation. On October 16, 1996, this same undercover operation led to the arrest of forty-six individuals and the institution of administrative proceedings by the SEC against twenty-nine of the individuals arrested.

- **November 25, 1997 -- Seventeen individuals indicted for stock fraud:** The SEC suspended trading in the stock of HealthTech and obtained an injunction requiring correction of the company's fraudulent financial statements. The SEC staff also worked with the United States Attorney in indicting seventeen individuals associated with the brokerage firm Meyers Pollack Robbins, Inc., including two high-level members of organized crime families, for securities fraud by the company and several brokers.

- **May 13, 1997 -- Brokerage firm and principals indicted:** The SEC brought emergency administrative action against the firm A.R. Baron for fraudulent sales practices, revoked Baron's broker-dealer registration and recovered significant investor funds. The Manhattan District Attorney's Office subsequently indicted A.R. Baron and thirteen individuals associated with Baron, including the firm's principals.

- **February 1997 – Thirty-two defendants pled guilty to criminal charges:** The Nevada United States Attorney obtained guilty pleas from thirty-two defendants on charges of racketeering, securities fraud, money laundering, illegal structuring of monetary transactions and conspiracy to commit securities fraud and wire fraud charges in connection with the sales of the stock of three microcap issuers. To date, the SEC has brought enforcement cases against a total of nineteen respondents in connection with undisclosed payments on the stocks of Enrotek Corporation, Teletek Inc., and United Payphone Services, Inc., which were involved in these criminal proceedings.

- **October/November 1996 – Market Manipulation in Systems of Excellence, Inc.:** The SEC suspended trading and obtained a TRO and asset freeze based on a market manipulation scheme in the stock of Systems of Excellence. The scheme which involved the misuse of Form S-8, included bribes paid to newsletter writers to promote and disseminate misleading information about the company over the Internet. Five individuals have plead guilty to related criminal charges.

- **February 1996 – Abuses of Regulation S:** The SEC instituted and settled proceedings against Candie's Inc., Salvatore Mazzeo and others based on their use of Regulation S in a scheme to evade the registration requirements of the securities laws.

In addition, the SEC is cracking down on individual brokers who engage in fraudulent practices which impact the microcap market. For instance, in November 1995 and May 1997, the SEC and the Department of Justice filed charges against twenty-eight rogue brokers throughout the country for engaging in a wide range of fraudulent conduct, including forging investor checks, engaging in unauthorized transfers of client funds, selling securities of nonexistent companies and creating false account statements.

The SEC's Enforcement Division has dedicated certain staff almost exclusively to coordinating its nationwide enforcement effort to address microcap issues. The goals of this group are to: intervene in microcap frauds at the earliest point possible to minimize investor harm; to enhance surveillance and coordination with the SEC's operating divisions as well as the NASD; and to coordinate a nationwide approach to microcap fraud with other state, federal and industry regulators.

In addition, the Enforcement Division is addressing the new technology through which frauds are being committed by dedicating resources to combat fraud on the Internet. To that end, the SEC's Division of Enforcement, with the assistance of other SEC staff, has assembled a group of professionals to conduct Internet surveillance. These professionals use the latest browsing software to monitor the Internet, including message areas such as newsgroups and bulletin boards.

B. Examination and Inspection Efforts

On the examination front, the SEC's broker-dealer examination program in the Office of Compliance Inspections and Examinations (OCIE) has prioritized the review of firms that specialize in underwriting, marketing, or retailing microcap stocks. The examination program operates as the SEC's "eyes and ears," uncovering the latest techniques used by broker-dealers, salespersons, and issuers to skirt the federal securities laws and defraud investors. These examinations frequently yield leads for investigations by the SEC's enforcement staff and the SROs.

In all areas of the country, particularly in New York, South Florida, and the Colorado/Utah area, examiners are targeting broker-dealers that have been the subject of customer complaints, have prior disciplinary actions against the firms or their principals that specialize in selling microcap stocks to retail investors, or are for other reasons believed to be engaging in microcap fraud. SEC examiners also are scrutinizing the records of microcap issuers maintained by registered transfer agents to detect irregularities in the issuance and transfer of shares which typically accompany frauds.

For example, examiners recently initiated an examination sweep of several firms that are players in the microcap market. The firms targeted for these examinations have many of the "red flags" of fraudulent microcap activity, such as customer complaints, significant profits from underwriting and subsequent aggressive market making of illiquid microcap securities, and large pools of inexperienced cold callers. Examiners arrived at the firms unannounced, and interviewed the firms' principals, registered representatives, sales assistants, and compliance staff. Examiners toured the premises including the "bull pens" or sales "pits" where cold callers make hundreds of telephone calls trying to sell securities to the public.

In these and in other examinations, we have made a number of observations about microcap firms. For example, while the supervisors of many firms state that their employees do not use sales scripts in making cold calls to the public, examiners often found a number of scripts on the desks of cold callers. In addition, it appears that most of the firms we examined only minimally supervise and train their armies of cold callers. Some supervisors merely walk through the sales pits, overhearing the sales pitches and randomly intercepting telephone conversations, and only reacting to problems disclosed in customer complaints. Many firms also claim they do not sponsor sales contests, though conversations with registered representatives in the bull pens revealed evidence of contests for the number of new accounts opened by cold callers.

Examiners are now hard at work analyzing hundreds of documents, such as trading records, commission payouts, and customer complaints, to reconstruct weeks of trading and conversations with customers. They will use these documents to determine if any of the firms engaged in the hallmark practices of microcap fraud: unauthorized trading or unsuitable bait and switch sales, refusal to sell securities when asked to do so by customers, exaggerated or fraudulent claims to potential customers to induce them to buy securities, manipulation of the market for securities, or working for or in cooperation with individuals who have been barred from the industry or known to be under

investigation for securities violations. Any evidence of abuse will be referred to the SEC's Division of Enforcement staff for further investigation and enforcement action.

The SEC also is coordinating its efforts to curb abuses in the microcap market with the SROs, including the NASD by focusing on the quality of supervision and on rogue brokers.. For instance, in 1994, the SEC staff with the NYSE and NASD conducted a review of the hiring, retention and supervisory practices of nine of the largest brokerage firms. Two years later, the SEC, together with the NASD, NYSE and the North American Securities Administrators Association, Inc. (NASAA) conducted a joint examination sweep to review the sales practices of selected registered representatives employed by small and medium-sized firms as well as the hiring, retention and supervisory practices of the brokerage firms that employ them. The sweep revealed that some firms employ registered representatives with a history of disciplinary actions and customer complaints, use only minimal hiring procedures, and have supervisors in branch offices who fail to review customer transactions adequately to detect sales abuses. The sweep also revealed that almost one-half of the branches that engage in cold calling were violating federal cold-calling rules.

As a result of that sweep, the SEC, NYSE, NASD and NASAA prepared a public report making specific recommendations designed to correct these problems. For example, the report recommends that brokerage firms institute more stringent hiring procedures for registered representatives; heighten supervision of registered representatives with a history of customer complaints, disciplinary actions or arbitrations; and train and supervise cold-callers. Finally, as part of its effort to combat microcap fraud, the SEC's examination staff is working with the SROs and the states to develop a training conference for securities examiners focused on the early detection of microcap fraud.

C. The SEC's Efforts to Combat Microcap Fraud Through Investor Education

Since an educated investor provides the best defense against securities fraud and often gives us the first warning of wrongdoing, the SEC's Office of Investor Education and Assistance (OIEA) educates investors on how to identify securities fraud and urges investors to report suspicious activity to securities regulators.

We urge investors to complain to us promptly. In 1997, we received nearly 18,000 complaints. Our database of complaint information tracks breaking trends, allowing us to identify problem brokers, firms, and financial products. The intelligence we gather from complaints helps to direct our examination and enforcement resources to the areas of greatest need first. The SEC has made it easier for investors to complaint over the Internet by creating the on-line Division of Enforcement Complaint Center at www.sec.gov/enforce/comctr.htm. The on-line complaint center presently receives over 100 complaints a day.

The SEC's efforts to reach out to investors include the following measures:

- **Publications**

Since 1994, OIEA has written and distributed over a dozen pamphlets and brochures that warn investors about scams and state in plain English what every investor should know about investing. All of these publications are available, free of charge, on the SEC's Website (http:\\www.sec.gov/invkhome.htm) and through the SEC's toll-free publications and information line (1-800-SEC-0330).

OIEA's newest publication, entitled Cold Calling Alert, specifically addresses problems in the microcap market. It tells investors what the cold-calling rules are, how to deal with cold calls, how to stop them, and how to evaluate investment opportunities that come over the telephone.

- **Investors' Town Meetings and Seminars**

To meet investors and listen to their concerns, in 1994 the SEC began to organize Investors' Town Meetings throughout the country. To date, Chairman Levitt has spoken at 22 town meetings. These events attract between 800 and 1200 investors and result in media coverage that reaches millions more. At each meeting, Chairman Levitt discusses questions investors should ask before they invest. Seminars follow the town meetings so investors can learn more about specific topics of interest.

In December 1997, the SEC announced an unprecedented national public awareness campaign about the importance of saving, investing, and avoiding securities fraud. The SEC, the North American Securities Administrators Association, and the Council of Securities Regulators of the Americas will launch the "Facts on Saving and Investing Campaign" throughout the Western hemisphere beginning on March 29, 1998. This educational campaign will include a wide range of simultaneous events throughout the Americas, including town meetings, school programs, and other educational activities in the United States. As planning progresses, a web site will be created to provide up-to-date information about the campaign.

3. FUTURE PLANS TO COMBAT PROBLEMS OF MICROCAP FRAUD

The SEC is also committed to reviewing and, if appropriate, revising the rules and regulations affecting the microcap market. The goal of our review is to close loopholes in existing rules and regulations which may be facilitating microcap fraud, and then, if needed, to develop new rules which will make such fraud less likely to occur in the first place.

In September 1997, the SEC formed a working group on microcap fraud to bring together top officials from the SEC's Divisions of Enforcement, Corporation Finance, and Market Regulation, as well as from the Office of Compliance Inspections and Examinations, the Office of General Counsel, and the Office of Investor Education and Assistance. The working group provides a forum where abuses uncovered by the enforcement and examination staffs and customer complaints can be

addressed by the SEC staff who write the rules for stock markets, for brokers and for raising capital. The working group has been meeting -- and will continue to meet -- regularly to exchange ideas and identify better ways to attack the current problems in the microcap market.

To date, the working group has focused on possible changes to the rules governing market-makers and clearing brokers and has begun to examine the costs and benefits of current capital formation rules. The working group also has been exploring how best to devise an early warning system for detecting fraud and how to use the SEC's enforcement resources most effectively to fight fraudulent practices in the microcap market. In addition, the working group is working with other regulators, such as the NASD and the states, and with the criminal authorities in sharing intelligence and devising creative and coordinated solutions to microcap fraud.

As a result of the efforts begun by the working group, several proposed rule/regulation changes already have been proposed by the SEC staff and will be considered by the SEC at an open meeting on February 10, 1998.

A. Rule and Regulations Changes to Be Considered on February 10, 1998

- **Exchange Act Rule 15c2-11 Governing Initiating and Resuming Quotations**

Rule 15c2-11 is intended to deter the publication of stock quotations in the OTC Bulletin Board, the Pink Sheets and similar media that may be used in fraudulent schemes. Before publishing the initial quotation for a particular stock, or after a trading halt, the current Rule requires brokers to review such information as the issuer's most recent balance sheet, profit and loss, and retained earnings statements; the nature of the issuer's business; the nature of the products or services offered; the nature and extent of the issuer's facilities; and any relationship between the broker-dealer and company insiders. As a result of the recent rise in microcap fraud, the SEC's staff recommended amendments to the Rule that would place greater information review requirements, and thus accountability, on broker-dealers publishing quotations for securities in a quotation medium other than a national securities exchange or Nasdaq and would provide greater investor access to information about those securities. Among other things, the proposals would: eliminate the Rule's "piggyback" provision, which currently permits broker-dealers (other than the initial broker-dealer) to quote the security without having current issuer information; require broker-dealers that publish priced quotations for a security to obtain and review updated information about the issuer at least annually; expand the information required about issuers that do not file periodic reports with the SEC; and, require documentation of the broker-dealer's compliance with the Rule. These amendments will be considered by the SEC on February 10, 1998.

- **Regulation S**

Regulation S provides a safe harbor from registration for certain off-shore offerings. The SEC has found that some issuers have used Regulation S as a means of indirectly distributing securities into the markets without registration. In light of these problems, in February 1997, the SEC proposed

amendments to Regulations S to prevent such unregistered distributions of the securities in the United States markets. On February 10, 1998, the SEC will be voting on the proposed final rule on this issue which would require, among other things, that: 1) equity securities placed offshore by domestic issuers under Regulations S be classified as "restricted securities" within the meaning of Rule 144, so that resales without registration are restricted; 2) the period during which issuers must comply with the Rule's offering restrictions be lengthened from 40 days to one year; and 3) certification, legending and other requirements, which currently are only applicable to sales of equity securities by non-reporting issuers, be imposed on these equity securities.

- **Form S-8**

Form S-8 is a short form that public companies may use to register sales of stock to their employees, consultants, and advisors as part of their compensation. These registration statements become effective automatically without SEC review. The staff has seen Form S-8 used improperly in connection with capital raising, either by using the shares to pay broker-dealers or other consultants that assist in capital raising or by using employees or "consultants" as intermediaries to raise capital indirectly.

On February 10, 1998, the SEC is considering, among other things, proposed changes to Form S-8 which would: 1) make Form S-8 unavailable for sales to consultants and advisors who directly or indirectly promote or maintain a market for the company's securities; and 2) require disclosure in Part II of Form S-8 of the names of any consultants or advisors to whom the registrant will issue securities under the registration statement as well as the amount and the nature of the consultant or advisory services.

B. Rule Changes to be Considered After February 10, 1998

Other rules which the SEC may review and consider in the future include the following:

- **The Penny Stock Rules**

Currently, the definition of "penny stock" excludes securities that, among other things, are priced at $5 or more per share. The SEC staff believes that the penny stock rules are very effective. However, some broker-dealers have circumvented their application by pricing securities above the current $5 threshold. The staff is considering a recommendation to raise the price threshold in conjunction with other possible changes to the penny stock rules to cover more of the types of securities that are used in microcap frauds. In evaluating this and other options, the SEC will carefully consider whether the proposed changes will be effective in curbing abuses, and not unduly interfere with the ability of legitimate smaller issuers to raise capital and compete with more established companies.

- **Rule 504 of Regulation D**

Rule 504 of Regulation D allows companies to raise up to $1 million per year in seed capital without complying with the registration requirements of the federal securities laws. In 1992, the SEC amended Rule 504 to eliminate the federal limitations on these offerings other than the general antifraud provisions and the requirement to file a notice with the SEC 15 days after the first sale. The staff is revisiting Rule 504 to determine whether changes need to be made. The staff will consider: 1) whether the exemption should be conditioned on state registration of the offering; and 2) whether the securities sold in certain exempt state offerings should be restricted. In reviewing this issue, the staff will be careful to: 1) balance the need of legitimate small businesses to raise capital efficiently with the continuing presence of fraud in the secondary markets; and 2) avoid imposing federal regulations that unnecessarily overlap state regulation of offerings.

- **NASD and NYSE Rules for Clearing Brokers**

The SEC published for public comments a rule proposal from the NASD (and a similar one from the NYSE) regarding the scope of a clearing broker's responsibility when it receives notice that an introducing broker may be engaged in fraudulent sales practices. Among other things, the proposed rule requires that clearing firms promptly forward to introducing firms and to the introducing firms' SROs any written customer complaints about the introducing firm. The comment period on the NASD's rule proposal has expired, and the NASD is considering whether to amend its proposed rule based on the comments received from the public. The Commission staff also is working with representatives from the industry, the SROs and the states to ensure that information from clearing firms about "red flags" at introducing firms is shared effectively with regulators.

- **Bulletin Board Standards**

Members of the SEC's working group on microcap fraud and the SEC's Division of Market Regulation have met with the NASD to discuss tightening regulations that govern the Bulletin Board. The NASD is now seeking comments from its membership on several microcap fraud initiates and ultimately will be sending the proposals to the SEC for its consideration.

ONE HUNDRED FIFTH CONGRESS

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JAMES E. DERDERIAN, CHIEF OF STAFF

U.S. House of Representatives
Committee on Commerce
Room 2125, Rayburn House Office Building
Washington, DC 20515–6115

February 10, 1998

The Honorable Janet Reno
Attorney General
Department of Justice
Constitution Ave. and 10th Street, N.W.
Washington, D.C. 20530

The Honorable Arthur Levitt, Jr.
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Ms. Mary Schapiro
President
NASD Regulation, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

Ms. Denise Voigt Crawford
President
North American Securities
Administrators Association, Inc.
One Massachusetts Ave., N.W.
Suite 310
Washington, D.C. 20001

Dear Attorney General Reno, Chairman Levitt, Ms. Schapiro, and Ms. Crawford:

I am writing to acknowledge receipt of your responses to my inquiry regarding so-called chop stock schemes and the fraud and abuse plaguing the micro-cap stock market. I have asked staff to review your responses, meet with your representatives, and advise me regarding the matters covered by your correspondence. Your responses will be embargoed from public release during that period which is expected to take a week to ten days.

In the interim, I would like to commend the SEC for scheduling today's open Commission meeting on proposals designed to stem the more rampant problems in this area. Some of these proposals represent changes to rules that, while designed in well-meaning zeal to facilitate capital raising, however, went too far and ended up facilitating fraud and abuse. The SEC is to be commended for recognizing this and acting expeditiously to protect investors, the SEC's principle mandate.

Thank you for your attention to this matter and to my request. I look forward to working with you.

Sincerely,

JOHN D. DINGELL
RANKING MEMBER

cc: The Honorable Tom Bliley
The Honorable Michael Oxley
The Honorable Thomas Manton
Mr. Mike Burnett (GAO)

U.S. Securities and Exchange Commission
Washington, D.C. 20549 (202) 942-0020

News Release

Media Contact: Chris Ullman, (202) 942-0020 98-14

SEC PROPOSES SEVERAL MEASURES TO COMBAT SECURITIES FRAUD AND ISSUES STATUS REPORT ON COMMISSION-WIDE MICROCAP FRAUD EFFORTS

Washington, DC, February 10, 1998--The Securities and Exchange Commission today proposed several new regulatory measures to combat microcap securities fraud and it issued a status report on the Commission's comprehensive, coordinated efforts to reduce fraud among these lower priced stocks. The Commission has a three-pronged approach to minimizing microcap fraud: enforcement, investor education and regulation.

"By considering measures to strengthen our regulations to reduce microcap fraud, we will send an unmistakable signal -- to market participants and investors alike: The Commission is firm in its resolve to protect America's markets from schemers who would skirt the law, scam the system, and swindle the investing public," said SEC Chairman Arthur Levitt.

Microcap companies are typically thinly capitalized and are often not required to file periodic reports with the SEC. Securities of microcap companies may be quoted on the Over-the-Counter Bulletin Board operated by the National Association of Securities Dealers, Inc., in the Pink Sheets operated by the National Quotation Bureau, and on the Nasdaq Small Cap Market. In any of these trading mediums, public information is limited and a small number of brokers control the market.

The "pump and dump" scheme is a typical microcap fraud. It often involves fraudulent sales practices, including high pressure tactics from "boiler room" operations where a small army of sales personnel cold call potential investors using scripts to induce them to purchase "house stocks" -- stocks in which the firm makes a market or has a large inventory. The information conveyed to investors often is at best exaggerated and at worst completely fabricated. Increasingly, these stocks also are being touted on the Internet by unregistered promoters. The promoters of these companies, and often company insiders, typically hold large amounts of stock and make substantial profits when the stock price rises following intense promotional efforts. Once the price rises, the promoters, insider and brokers sell, realizing their profits.

"In undertaking these revisions, we are sensitive to any inadvertent impact these proposals may have on the liquidity of thinly-traded issues," Chairman Levitt said. He added, "Nevertheless, we recognize that -- as professionals in a regulated industry -- market-makers must be more that mere order-takers. In publishing a price quotation, a market-maker lends credibility to a security. But if he doesn't know anything about the security, he does a disservice to the investor -- and to himself."

Investors seeking additional information should contact the SEC at (800) SEC-0330, or through our website at www.sec.gov.

Attached is a list of measures investors should take to protect themselves.

# # #

INVESTIGATE BEFORE YOU INVEST

Before handing over your hard-earned money, take the time to investigate.

1. **Ask Questions** Call your state's securities regulator, and ask:
   - Is the investment registered?
   - Are the broker and the firm licensed to do business in my state?

   You can get that number by calling the North American Securities Administrators Association toll-free at (888) 846-2722.
2. **Know Your Broker** Ask your state's securities regulator if they've received complaints against either the broker or the firm pushing the deal. Or call the National Association of Securities Dealers' toll-free public disclosure hot-line at (800) 289-9999.
3. **Know the Investment** How long has the company been in business? What are its products or services? Has the company made money for investors before?
4. **Get the Facts in Writing** Don't get swept away by a sales pitch. Ask for – and read carefully – the company's prospectus or latest annual report.

For more tips on how to invest wisely and protect yourself against investment fraud, call the U.S. Securities and Exchange Commission toll-free at (800) SEC-0330, or visit our website at *www.sec.gov*. Our free publications include:

Ask Questions — Questions you should ask about your investments, the people who sell them, and what to do if you run into problems.

Cold Calling — Tells you the rules on cold calling, how to deal with cold calls, how to stop them, and how to evaluate any investment opportunity to comes your way over the telephone.

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JAMES E. DERDERIAN, CHIEF OF STAFF

U.S. House of Representatives
Committee on Commerce
Room 2125, Rayburn House Office Building
Washington, DC 20515–6115

March 16, 1998

The Honorable Janet Reno
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Washington, D.C. 20530

The Honorable Arthur Levitt, Jr.
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
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Ms. Mary Schapiro
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Ms. Denise Voigt Crawford
President
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Administrators Association, Inc.
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Dear Attorney General Reno, Chairman Levitt, Ms. Schapiro, and Ms. Crawford:

I am writing to thank you and commend you for your responses to my inquiry regarding the fraud and abuse plaguing the micro-cap stock market. I also appreciate the detailed briefing that your staffs provided four weeks ago. In response, I would like to make a few observations.

First, your enforcement efforts appear to be marked by an exceptional level of cooperation and coordination. Also, the number of criminal prosecutions has increased, reflecting both an increased willingness of prosecutors to take on these complex cases and a higher level of support being provided to U.S. attorney's offices by experienced SEC and NASDR enforcement staff. However, the ability to meet the growing demand for such support in the future is in question due to limited SEC and NASDR resources. Moreover, the sentencing guidelines for white collar crime are not tough enough to effectively punish and deter the miscreants, given the huge sums involved in today's stock market.

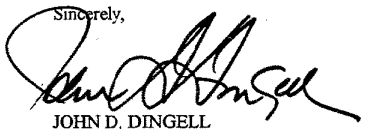
The coordinated approaches that you are taking to the conduct of surprise sweeps -- catching people in the act before they can hide or shred misleading sales scripts -- is laudable, as is your coordinated approach to bettering investor education. Financial illiteracy is a big part of the problem.

The SEC's recent rules and regulations changes are a good first step at stemming many of the types of fraudulent schemes uncovered by your enforcement actions, but more remains to be done. Prompt action is needed to address abuse and fraud associated with introducing brokers and clearing firms. However, in revising the rules and regulations in the micro-cap area, SEC and NASDR must keep in mind that there are a great many honest companies and honest market makers in this market and their ability to function efficiently must not be impaired. It is important that you seek and consider their input as you undertake regulatory reforms.

State securities regulators are an integral part of the solution to this problem. There seems to be a concentration of fraudulent firms in the New York City metropolitan area but the New York State Attorney General does not have statutory authority to conduct routine examinations and inspections of broker-dealer firms and their branch offices. This is an outrage. California is strong on corporate finance but weak on licensing and examinations. These and other deficiencies should be addressed as soon as possible in order to strengthen the lines of defense against unscrupulous brokers and disreputable firms.

Again, I commend you for your responses and your continuing efforts to address this serious problem and restore the integrity of this important marketplace. I respectfully request that you update your responses in six months and, in the meantime, that you cooperate with GAO in the investigation and reporting that I have asked them to do.

Sincerely,



JOHN D. DINGELL
RANKING MEMBER

cc: The Honorable Tom Bliley
The Honorable Michael Oxley
The Honorable Thomas Manton
Mr. Mike Burnett (GAO)

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JAMES E. DERDERIAN, CHIEF OF STAFF

U.S. House of Representatives
Committee on Commerce
Room 2125, Rayburn House Office Building
Washington, DC 20515–6115

December 12, 1997

The Honorable James F. Hinchman
Acting Comptroller General
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Hinchman:

I am transmitting a copy of my correspondence with federal and state regulators regarding the highly-publicized increase in fraud in micro-cap stocks. In light of the excellent work done by GAO on related issues in the past, I am writing to request that GAO conduct certain audits and provide us with a report of your findings and any recommendations you deem appropriate with respect to the following (and any other items you deem necessary and appropriate to assist us in fully understanding and addressing this serious problem):

Penny Stocks and Rogue Brokers. In 1993, you submitted to the House Committee on Energy and Commerce and to the Senate Banking Committee a report on the National Association of Securities Dealers' (NASD) efforts to reduce fraud and abuse in the penny stock market. The report discussed changes to the NASD's oversight procedures for broker-dealers who conduct business in penny stocks, and recommended improvements in the NASD's procedures for informing investors of broker-dealers' disciplinary histories and for examining branch offices. It also discussed listing and delisting practices of the NASD and stock exchanges. See, Penny Stocks: Regulatory Actions to Reduce Potential for Fraud and Abuse (GAO/GGD-93-59, February 1993). The following year, you submitted to this Committee's Subcommittee on Oversight and Investigations and Subcommittee on Telecommunications and Finance a report that reviewed the oversight and disciplinary actions of the Securities and Exchange Commission (SEC) and several of the securities industry's self-regulatory associations against rogue brokers. The report discussed (1) the extent to which rogue brokers are active in the securities industry and (2) regulatory and industry efforts to identify and discipline unscrupulous brokers, and recommended improvements in the detection and discipline of these brokers. See, Securities Markets: Actions Needed to Better Protect Investors Against Unscrupulous Brokers (GAO/GGD-94-208, September 1994).

As a starting point, please update these reports and advise us of the extent to which GAO's recommendations either have been properly implemented or remain undone, and assess the effectiveness of any changes that have been made. In conjunction with this work, please also review the findings and recommendations of the March 1996 NASD-NYSE-NASAA-SEC Joint Regulatory Sales Practice Sweep and report on the extent to which those recommendations have been implemented or remain unaddressed, and assess the effectiveness of any changes that have been made.

Key Issues. I respectfully request that your report include or address these points:

1. The classes and characteristics of the stocks involved in these scams;

2. The classes and characteristics of the perpetrators;

3. The frauds and abuses and how they are carried out--

On May 29, 1997, NASAA announced that 20 state securities agencies had filed 37 actions against 14 firms operating in the micro-cap market. In the course of their sweep, state examiners discovered four systemic abuses--

Trading Abuses. State examiners found an army of unlicensed solicitors who are accused of falsifying records, conducting unauthorized trades, and failing to complete trades.

Failure to Report Investor Complaints. Most of the offices audited failed to have centralized procedures for handling and reporting customer complaints, as required by law. Examiners found hundreds of unreported investor complaints.

Evasion of Broker-Dealer Registration Requirements Through Use of Third-Party Franchise Agreements. In a February 24, 1997, article, "Beware the scalpers," Forbes warned about the rapidly increasing networks of broker-dealer branch offices, many of which are one-person branches operated by independent contractors, operating just beneath the regulatory radar screen and fleecing investors with abandon. State examiners found that these "franchises"operate independently, with no central compliance or supervisory procedures or oversight as is industry practice. However, they do not have independent capital and bonding upon which the investing public relies.

Abusive Cold-Calling Practices. Most of the firms and branches examined relied on high-pressure, scripted telephone cold calling techniques that include falsifying experience and performance, among other outright lies.;

4. The relationship between introducing brokers and clearing firms;

5. The adequacy of the current legal and regulatory framework, including, among other things, licensing requirements and books and records requirements, at both the federal and state levels;

6. The adequacy of enforcement tools and resources at both the federal and state levels (see, e.g., "Departure of Many Lawyers at SEC Stretches Its Resources, Delays Cases," Wall Street Journal, Wednesday, November 19, 1997 at B13) and the degree and effectiveness of coordinated efforts; and

7. The ability of investors to recover their losses, through the efforts of federal and state regulators or private lawsuits. In 1992, you submitted a report to the Senate Banking Committee and to this Committee's Subcommittee on Oversight and Investigations on the operations of the Securities Investor Protection Corporation (SIPC) with recommendations to improve SEC and SIPC disclosures to customers and SEC's oversight of SIPC's operations. See, Securities Investor Protection: The Regulatory Framework Has Minimized SIPC's Losses (GAO/GGD-92-109, September 1992).

   Please update that report. Have GAO's recommendations been implemented? Is this protection still sufficient for investors? With the increase in fraud, should action other than a firm's financial failure be cause to trigger the coverage?

Thank you for your cooperation and attention to this request.

Sincerely,

JOHN D. DINGELL
RANKING MEMBER

Enclosure

cc: The Honorable Tom Bliley
The Honorable Michael Oxley
The Honorable Thomas J. Manton

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JAMES E. DERDERIAN, CHIEF OF STAFF

U.S. House of Representatives
Committee on Commerce
Room 2125, Rayburn House Office Building
Washington, DC 20515–6115

October 14, 1998

The Honorable Arthur Levitt, Jr.
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Chairman Levitt:

In the wake of widespread reports of rampant fraud in microcap stocks, I asked the General Accounting Office (GAO), by a letter dated December 12, 1997, to conduct a comprehensive review of this problem. GAO has divided this task into several discrete assignments.

Their first report, SEC Enforcement: Responses to GAO and SEC Recommendations Related to Microcap Stock Fraud (GAO/GGD-98-204, September 30, 1998), looks at the status of SEC and self-regulatory organization (SRO) actions taken in response to recommendations in prior GAO and SEC reports that address issues related to microcap stock fraud.

The report's appendix details numerous new, amended, and proposed SEC, NASD, and NYSE rules related to microcap fraud. GAO concludes that SEC and the SROs have taken, or reported taking, actions, in some cases self-initiated, that respond to many of the recommendations in prior GAO and SEC reports.

However, GAO reports that actions have not been taken on four critical issues: (1) migration of unscrupulous brokers from the securities industry to other financial services industries; (2) ability of SEC to identify, across firms, trends in violations found during its broker-dealer examinations; (3) modernization of the central registration database (CRD) to improve oversight of problem brokers and public access to broker disciplinary histories; and (4) provision of information to investors on the availability of broker disciplinary histories before activity occurs in an account. (GAO Report at 2 and 11). Failure to address these problems with deliberate speed leaves major gaps in regulatory oversight and investor protection.

For example, CRD upgrades began in 1992, have experienced continuous unjustified delays, and are not yet complete. Every projected deadline has been missed. This has had serious implications for state investor protection programs. For example, the New York Attorney General office's plan to require brokers to disclose their disciplinary records to investors is being held up by

delays in upgrading the CRD database. See "N.Y. Plan For Reps To Reveal Histories Delayed By CRD," Wall Street Letter (August 3, 1998) at 6 (copy enclosed). GAO reports that full implementation of all system improvements, including enhanced regulatory functions and full Internet access, is scheduled for late 1999 (GAO Report at 9-10). But an NASD spokeswoman is quoted in the WSL article that "nothing is a definite drop dead date." With all due respect, it should be.

On February 9, 1998, you wrote to me in your microcap stock fraud response:

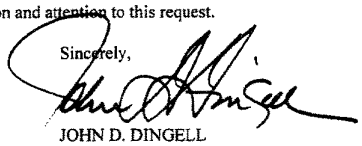
> "I view as unacceptable the possibility that any segment of this nation's securities markets has become rife with fraud and abuse .... I believe that it is critical that the SEC, other federal and state regulators, the self-regulatory organizations, and industry leaders and investor advocates, aggressively combat this egregious form of securities fraud."

These are wise words and I intend to hold you to them.

Accordingly, I respectfully request that the SEC submit semi-annual reports (in March and September) on progress in addressing the outstanding recommendations and, in furtherance of that goal, that you require NASD to submit to your agency quarterly reports on the status of their CRD upgrades.

Thank you for your cooperation and attention to this request.

Sincerely,



JOHN D. DINGELL
RANKING MEMBER

Enclosures

cc: The Honorable Thomas J. Bliley, Jr.
Chairman, Committee on Commerce

The Honorable Michael G. Oxley
Chairman, Subcommittee on Finance and Hazardous Materials

The Honorable Thomas J. Manton
Ranking Member, Subcommittee on Finance and Hazardous Materials

The Honorable James F. Hinchman
Acting Comptroller General, U.S. General Accounting Office

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JAMES E. DERDERIAN, CHIEF OF STAFF

U.S. House of Representatives
Committee on Commerce
Room 2125, Rayburn House Office Building
Washington, DC 20515–6115

April 13, 1999

The Honorable David M. Walker
Comptroller General
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Walker:

I am writing with further reference to your September 1998 report SEC Enforcement: Actions Reported on GAO and SEC Recommendations Related to Microcap Stock Fraud. In that regard, I am transmitting the responses of the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) and respectfully request that GAO determine whether the actions outlined in these responses satisfy the remaining GAO recommendations.

First, DOJ writes that "continued cooperation and coordination between the regulatory and law enforcement communities are essential to the success of our joint efforts to address this and other threats to our nation's investors. The Department is committed to maintaining this concerted approach." I agree and I commend them for this. Without it, the regulatory efforts will be without teeth. I intend to conduct vigorous oversight in this area to see that this commitment to cooperative and coordinated enforcement is maintained.

Second, GAO's microcap report noted that actions on four recommendations had not been completed: (1) migration of unscrupulous brokers from the securities industry to other financial services industries; (2) reporting and trend analysis of violations found in broker-dealer examinations; (3) the modernization of the Central Registration Depository (CRD) to improve oversight of problem brokers and public access to broker disciplinary histories; and (4) access of information to investors about broker disciplinary histories before activity occurs in an account.

The SEC has submitted a 9-page memorandum detailing SEC and self-regulatory organization (SRO) actions to address these areas. It also describes other initiatives taken in addition to the GAO recommendations.

I note two matters that require legislative action.

On the migration problem, there has been scant progress and more needs to be done. SEC notes (p. 2) that an important first step would be completion of the CRD modernization project. However, the SEC reports (p. 5) that the CRD project has hit another snag: the NASD has delayed their plans to display disciplinary information on its web page because of concerns regarding immunity in state law defamation cases. NASD is concerned that they are not protected from possible lawsuits by brokers who feel they may be damaged by information posted on the web. Section 15A(i) of the Exchange Act provides that the NASD shall not be liable under state law to any person for information it provides to investors over the telephone.[1] Concerns have been raised that this section may not protect the NASD for information it discloses over its Internet web site. Therefore, NASD believes that an amendment to the Exchange Act, expressly allowing disclosure over the Internet, is necessary to implement these disclosures.

Recent press reports ("Hands Off? A Senate leader attacks moves to regulate Internet trading," Barron's, April 12, 1999, at 19) indicate that Senate Banking Committee Chairman Phil Gramm is conducting a review of the costs and burdens of existing regulation on Internet trading and will be coming forth with legislation to "repeal old laws that have gone bad." The article quotes "Gramm theorems" including that the Internet polices itself, with good information driving out the bad. If this report is accurate, it would appear that this bill would be an appropriate vehicle for amending section 15A so that investors can have Internet access to broker disciplinary histories. I will pursue that amendment should this or any other appropriate legislation be considered by the House.

Further, the SEC notes (pp. 2-3) that concerns, analogous to those raised by the GAO, may also arise in connection with the migration of unscrupulous persons from the banking and insurance sector into the securities industry. U.S. federal securities laws do not currently prevent persons subject to disciplinary findings by state securities, banking and insurance commissions, and federal banking agencies, from entering the securities industry. SEC says that it would be helpful to amend the Exchange Act to make persons subject to a "statutory disqualification" if

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[1] Section 15A(i) was added to the Exchange Act in 1990 by the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, P.L. 101-429, and provides:

> (i) A registered securities association shall, within one year from the date of enactment of this section, (1) establish and maintain a toll-free telephone listing to receive inquiries regarding disciplinary actions involving its members and their associated persons, and (2) promptly respond to such inquiries in writing. Such association may charge persons, other than individual investors, reasonable fees for written responses to such inquiries. Such an association shall not have any liability to any person for any actions taken or omitted in good faith under this paragraph.

they have been found by a state securities or insurance commission, or state or federal banking agency, to have committed certain fraudulent acts or violated the statutes enforced by these agencies.

The Commerce Committee is currently considering H.R. 10, the Financial Services Act of 1999, to provide a prudential framework for the affiliations of banks, securities firms, insurance companies, and other financial service providers. The Administration has admonished us against sending a bill with "inadequate consumer protections" to the President. (*See, e.g.*, March 2, 1999, letter from President Clinton to Senator Phil Gramm.) I believe that the amendment suggested by the SEC would be a good candidate for inclusion in H.R. 10 and I intend to pursue it during our deliberations on the Committee amendment to H.R. 10.

Thank you for your cooperation and attention to this request. I look forward to receiving your follow-up report, and I trust that GAO staff will be available this summer to work with Committee staff to design and complete the outstanding microcap stock fraud work requested in my original correspondence.

Sincerely,

JOHN D. DINGELL
RANKING MEMBER

cc: The Honorable Tom Bliley, Chairman
Committee on Commerce

The Honorable Michael Oxley, Chairman
Subcommittee on Finance and Hazardous Materials

The Honorable Edolphus Towns, Ranking Member
Subcommittee on Finance and Hazardous Materials

The Honorable Arthur Levitt, Jr., Chairman
Securities and Exchange Commission

The Honorable Karen A. Robb, Deputy Assistant Attorney General
U.S. Department of Justice, Office of Legislative Affairs

U.S. Department of Justice

Office of Legislative Affairs

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Office of the Assistant Attorney General *Washington, D.C. 20530*

DEC 14 1998

The Honorable John Dingell
U.S. House of Representatives
Washington, DC 20515

Dear Congressman Dingell:

This responds to your March 1998 letter to the Attorney General in which you requested a six month update concerning the Department's response to your inquiry last year about media reports on microcap or "chop stock" schemes. Shortly after your initial inquiry, we joined our colleagues from the Securities and Exchange Commission, the National Association of Securities Dealers Regulation, and the North American Securities Administrators Association, to brief a member of your staff about our coordinated approach to addressing these schemes.

In September, the General Accounting Office (GAO) published a report on microcap stock fraud that focused on the actions taken by the SEC and self regulatory organizations to combat this fraud. The GAO report noted that these actions should enhance regulatory oversight of microcap stock firms and help provide investors with additional protections against abusive practices by such firms. We recognize, however, that continued cooperation and coordination between the regulatory and law enforcement communities are essential to the success of our joint efforts to address this and other threats to our nation's investors. The Department is committed to maintaining this concerted approach.

Thank you for your interest in the Department's securities fraud enforcement program. Please do not hesitate to contact the Department if we can be of further assistance with regard to this or any other matter.

Sincerely,

Karen A. Robb
Deputy Assistant Attorney General

THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

March 31, 1999

The Honorable John D. Dingell
Ranking Member
Committee on Commerce
United States House of Representatives
2322 Rayburn House Office Building
Washington, D.C. 20515-6115

Dear Congressman Dingell:

Enclosed is a memorandum that responds to your letter dated October 14, 1998, pertaining to the General Accounting Office (GAO) Report entitled SEC Enforcement: Actions Reported on GAO and SEC Recommendations Related to Microcap Stock Fraud (GAO Report). The GAO Report details the numerous actions that the SEC and the self-regulatory organizations (SROs) have taken to combat microcap stock fraud as well as certain areas where further improvements can be made. I have asked my staff to prepare the attached memorandum, to address your questions regarding progress on the outstanding GAO recommendations.

Combating microcap fraud continues to be a high priority for the Commission and the SROs. The accomplishments and ongoing efforts discussed in the GAO Report and our attached memorandum reflect this commitment. We look forward to working with you on our continued efforts in this important area of investor protection.

If you have any questions, please contact me or Annette Nazareth, the Director of the Division of Market Regulation, at (202) 942-0090.

Sincerely,

Arthur Levitt

Enclosure

MEMORANDUM

TO: Arthur Levitt, Chairman

FROM: Annette L. Nazareth, Director
Division of Market Regulation

DATE: March 31, 1999

RE: Response to Congressman John D. Dingell Regarding SEC and SRO Efforts Relating to Fraud in Microcap Stocks

This memorandum responds to Congressman Dingell's request for semi-annual updates from the Securities and Exchange Commission's (SEC) progress in addressing General Accounting Office (GAO) recommendations regarding efforts to combat fraud involving microcap stocks.

I. BACKGROUND

On December 12, 1997, Congressman Dingell asked the GAO to conduct a comprehensive review of fraud involving microcap stocks. The GAO responded with a report, SEC Enforcement: Actions Reported on GAO and SEC Recommendations Related to Microcap Stock Fraud (GAO/GGD-98-204, September 30, 1998)(GAO Report), which reviewed the status of SEC and self-regulatory organization (SRO) actions taken in response to recommendations made in prior GAO and SEC reports. As the GAO Report noted, the SEC and SROs have taken numerous actions to combat microcap stock fraud. The GAO Report further noted that actions on four recommendations have not been completed: (1) migration of unscrupulous brokers from the securities industry to other financial services industries; (2) reporting and trend analysis of violations found in broker-dealer examinations; (3) the modernization of the Central Registration Depository (CRD) to improve oversight of problem brokers and public access to broker disciplinary histories; and (4) access of information to investors about broker disciplinary histories before activity occurs in an account.

As described below, the SEC and SROs have been working to address these areas. We have also outlined additional efforts by the SEC and the SROs to combat microcap fraud.

II. STATUS OF RECOMMENDATIONS

1. Migration of Rogue Brokers

The GAO study raised concerns about the migration of unscrupulous brokers into other segments of the financial services industry, such as banking and insurance. The GAO recommended that the Department of Treasury work with the SEC and other financial regulators to (1) increase disclosure of CRD information so that regulators can consider a broker's disciplinary history in allocating examination resources and employers can use the information in making hiring decisions; and (2) determine whether legislation or additional reciprocal agreements between the SEC and other financial regulators are necessary to prevent the migration of unscrupulous brokers to other financial services industries.

In 1996, the Commission staff met with representatives from the National Association of Securities Dealers (NASD), the North American Securities Administrators Association, Inc. (NASAA), and the National Association of Insurance Commissioners (NAIC), to discuss steps that could be taken to stem the migration of unscrupulous brokers. At that meeting, it was agreed that an important first step would be to complete the CRD modernization project (see discussion below on status of CRD). The participants also discussed ways for additional regulatory authorities to obtain access to the insurance industry's Producer Database (PDB).[1] It is expected that the CRD modernization program and other avenues of information sharing between federal and state securities, insurance and banking regulators, intended to address the possible migration of unscrupulous brokers, will be discussed at the upcoming Conference held by NASAA and the Commission on Federal-State Securities Regulation.[2] Although the migration of unscrupulous brokers within the financial services industry has been discussed at previous conferences, the CRD modernization has been the primary focus.

Concerns, analogous to those raised by the GAO, may also arise in connection with the migration of unscrupulous persons from the banking and insurance sector into the securities industry. U.S. federal securities laws do not currently prevent persons subject to disciplinary findings by state securities, banking and insurance commissions, and federal

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[1] PDB, which provides information on "producers" (the collective industry term for both insurance agents and insurance brokers), can be accessed through the Internet and offers demographic license summary information, certification and clearances, regulatory actions and NASD examination information. Only insurance companies can currently access the PDB, with the payment of a fee. Twenty states currently contribute to the PDB, representing over 1.8 million producers.

[2] The next meeting is scheduled for April 19, 1999. These annual conferences are intended to carry out the policies and purposes of section 19(c) of the Securities Act of 1933, adopted as part of the Small Business Investment Incentive Act of 1980, to increase uniformity in matters concerning state and federal regulation of securities, to maximize the effectiveness of securities regulation in promoting investor protection, and to reduce burdens on capital formation through increased cooperation between the Commission and the state securities regulatory authorities.

banking agencies,[3] from entering the securities industry. It would be helpful to amend the Securities Exchange Act of 1934 (Exchange Act), to make persons subject to a "statutory disqualification"[4] if they have been found by a state securities or insurance commission, or state or federal banking agency, to have committed certain fraudulent acts or violated the statutes enforced by these agencies.

2. Reporting and Trend Analysis of Violations Found in Examinations

The GAO Report reiterates a 1991 recommendation that the SEC explore ways to record and maintain information on the number of each type of violation found during on-site examinations of broker-dealers and include this information in its examination tracking system. Staff from our Office of Compliance Inspections and Examinations (OCIE), in conjunction with the Office of Information Technology, are working to develop an examination tracking system to replace its current broker-dealer examination tracking system by FY 2000. In May 1998, a *requirements analysis* was completed for a new examination tracking system called the Super Tracking and Reporting System (STARS). System development began in the fall of 1998. As of this date, STARS has been deployed for testing in OCIE and selected regional offices. As a tool for identifying and analyzing trends in violations, STARS will enable home and regional office staff to make *ad hoc* queries of the database and will interface with other Commission databases. For instance, SEC staff will be able to query the number of firms within the State of New York that have been cited in examinations for books and records violations or fraudulent conduct.

The GAO Report notes that STARS will not be designed to capture data on the number of times each type of rule violation occurred (e.g., the number of trades, records, or accounts). The staff believes that quantifying the number of times a violation is documented in examinations of broker-dealers would add complexity in operating STARS without enhancing the staff's ability to analyze trends in violations. Reviewing the number of times violations are found at different firms may not yield comparable data because sample sizes and review periods vary in every examination, depending on the firm's business, size, and compliance history. More meaningful indicators of the significance and extent of violations are the monetary value and the period over which violations occurred, but only when viewed in the context of all the relevant facts and circumstances. Therefore, the staff believes that this information cannot be reduced to a statistical summary. However, in order to gather more information about the significance and extent of violations found in examinations, OCIE is storing the full text of all current reports on the *Zyindex* system. This system enables the staff to conduct searches of all reports using keywords and to compile an analysis of the information.

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[3] These would include the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation and the Office of Thrift Supervision.

[4] See Exchange Act Section 3(a)(39).

The GAO Report concluded that if STARS and the Zyindex system are implemented as described, these enhanced capabilities would be consistent with GAO's recommendation that the SEC be able to analyze, across firms, trends in violations found during our examinations of broker-dealers. See GAO Report at p. 24.

3. Central Registration Depository

The GAO Report notes that efforts to incorporate technological improvements have delayed the redesign of the CRD system. The NASD, together with the SEC, NASAA and industry representatives, meet regularly to discuss the modernization of the CRD system. The NASD has made significant efforts to involve users in the design and functionality of the CRD. It sought participation from industry, other SROs, state regulators and the SEC on a wide range of issues, from defining system requirements to reviewing system prototypes. The NASD has held regular meetings among policy groups, technology departments, and registration managers. Presentations on CRD are included in NASD Regulation Conferences, as well as special CRD/Public Disclosure Conferences. Although the upgrades to the CRD are not yet complete, the NASD has made reasonable progress and is devoting significant resources to the project. The NASD has made a substantial investment in technology and development for the modernized CRD.

Congressman Dingell requested that the SEC require the NASD to submit quarterly reports on the status of the CRD modernization effort. The NASD submitted its first quarterly report in February 1999. The following comments are based on an analysis of that report and our discussions with the NASD.

The modernized system (Web CRD) will provide a host of enhancements, from improved registration and relicensing to electronic form filing. Electronic form filing is scheduled for implementation in August of this year. In addition to electronic filing, Web CRD will employ a number of completeness checks to alert firms that information necessary for processing their filing is missing before the filing is submitted to the CRD. Costly registration delays resulting from deficient filings will be substantially reduced.

In the past year, NASAA, NASD, the SEC and others have worked together to modify the Forms U-4, U-5 and BD in order to accommodate electronic filing. The NASD has submitted, and the Commission is currently reviewing, a rule proposal to modify Forms U-4 and U-5. The NASD proposes additional formatting and technical changes to the forms in order to fully implement Web CRD. The Commission is also considering revisions to Form BD to accommodate electronic filing.

The regulatory community, including the SEC, state regulators, and the SROs will also benefit this year from the implementation of other key components of the modernized system. On a limited basis, in Fall 1999, regulators will be notified of key filing events that occur in CRD. For example, a notification will be sent to regulators when a firm has changed its business activities, as disclosed on Form BD. Web CRD is expected to allow regulators to conduct various searches of the database for registered representatives or

broker-dealers that meet certain criteria. For example, a search could be done for all registered representatives who have filed for bankruptcy.

In 1998, the SEC approved a rule proposal expanding the NASD's public disclosure program to allow them to respond to electronic inquiries, as well as written or telephone inquiries. This allowed investors to go to NASDR's Internet web site at <http://www.nasdr.com> and request information on any currently registered individual or broker-dealer. Information about a broker's registration is immediately available for viewing. Disciplinary information is available through either the toll-free hotline, or by requesting an e-mail report on the NASDR web page.

The NASD has recently delayed their plans to display disciplinary information on the web page because of concerns regarding immunity in state law defamation cases. NASD is concerned that they are not protected from possible lawsuits by brokers who feel they may be damaged by information posted on the web. Section 15A(i) of the Exchange Act provides that the NASD shall not be liable under state law to any person for information it provides to investors over the telephone. Concerns have been raised that this section may not protect the NASD for information it discloses over its Internet web site. Therefore, as we have discussed with Congressman Dingell's staff, the NASD believes that an amendment to the Exchange Act, expressly allowing disclosure over the Internet, is necessary to implement these disclosures.

The NASD reports that Web CRD's design and development will be Y2K compliant. Certification of the application is scheduled to begin in April 1999. A re-certification will occur prior to August to account for any software changes that might occur after the April certification process. The NASD reported that Web CRD provides a comprehensive and effective set of security measures that ensure: (1) only authorized users gain access to the systems; (2) users perform only the functions for which they are entitled; (3) users obtain and modify only data to which they are entitled; and (4) users' activities in the system are protected from detection and manipulation by others.

Generally, we think that the decision by the NASD in 1997 to reassess the redesign of the CRD and the subsequent decision to use web-based technology was the correct course of action, even though it caused significant delays. The original redesign concept would not have allowed the expanded regulatory and disclosure functions that are part of the newer modernization system. The NASD has met its key deadlines. For example, in 1998 the NASD's public disclosure program became available on the NASDR web page. This year they are currently on target to conduct an industry wide test of the system, involving firms, SROs, state regulators, and the SEC. In addition, the NASD is preparing for a two-week transition period in August of this year to initiate electronic filing. By mid 2000, the NASD intends to finalize enhancements of the administrative and regulatory tools that will be available in Web CRD. We intend to continue to work closely with the NASD to ensure that it meets its commitment to regulators, the industry, and the public to provide a system that is workable and effective.

4. Disclosure of Disciplinary History

In 1994, the SEC's Large Firm Report recommended that information on the availability of a broker's disciplinary history through the NASD's toll-free hotline be disclosed to investors before any activity occurs in their accounts. It is important to note that this recommendation was made before there were other means of making disclosure widely available, such as through the Internet. In 1996, the GAO issued a report of its review of the NASD's Public Disclosure Program (PDP). The report included a recommendation that the NASD publicize and educate investors about the availability of information through the NASD's PDP.

Subsequently, the SEC approved NASD Rule 2280, which requires certain NASD members to provide to customers in writing, at least annually, information on the availability of broker disciplinary information through the NASD's toll-free hotline along with the Internet web site address of the NASDR's PDP, and a statement regarding the availability of an investor brochure describing the PDP. The NASD's rule filing gives its members the flexibility to determine whether to include the information on customer account statements or some other type of publication. Given the costs associated with alternative forms of disclosure, the NASD's approach seems to be a reasonable method of disseminating this information.

III. OTHER ACTIONS

The SEC is engaged in a four-pronged approach to combating microcap fraud, involving enforcement, inspections, education, and regulation. We are taking a variety of actions in addition to those included in the GAO recommendations. Many of these initiatives are noted in the Appendix to the GAO Report. The following is an update on actions since the GAO Report was issued.

- Regulatory

Rule 504 is the limited offering exemption designed to aid small businesses in raising seed capital without complying with Securities Act registration requirements. The freely tradable nature of securities issued in Rule 504 offerings facilitated a number of fraudulent market manipulations. The SEC adopted amendments to Rule 504 of Regulation D designed to deter microcap fraud while preserving the ability of legitimate small businesses to raise capital. See Securities Act Release No. 7644 (February 25, 1999).

Form S-8 is a short form used to register the offer and sale of securities to an issuer's employees. The SEC adopted amendments to Form S-8 that are designed to deter abuse of the form to issuing securities in capital raising transactions and to issue securities as compensation to stock promoters. See Securities Act Release No. 7646 (February 25, 1999). Also proposed were additional amendments to Form S-8 designed to further deter abuse. See Securities Act Release No. 7647 (February 25, 1999).

The SEC also recently published notice of the NASD's rule filings to amend its Rules 2315 and 6740 to require brokers to review current financial statements information about an over-the-counter (OTC) issuer before recommending its securities to customers.

The SEC also approved amendments to NASD Rules 6530 and 6540 on January 4, 1999. The amendment to Rule 6530 limits quotations on the OTC Bulletin Board (OTCBB) to the securities of issuers that are current in their reports filed with the Commission or other regulatory authority. The amendment to Rule 6540 prohibits a member from quoting a security on the OTCBB unless the issuer is current in its filing obligations with the Commission. This rule will be phased in over the next eighteen months.

In February 1999, the SEC reproposed amendments to Rule 15c2-11 to deter fraud in the OTC market by increasing the amount of information available to brokers and investors. See Securities Exchange Act Release No. 41110 (February 25, 1999). This rule governs the publication of quotations for securities in a medium other than a national securities exchange or Nasdaq. These reproposed amendments focus on microcap securities.

The staff is also working with the securities industry to develop other measures to reduce microcap fraud. For example, based on a suggestion by SEC staff, an industry group including the Securities Industry Association, the National Securities Clearing Corporation (NSCC), and others are discussing a plan whereby the NSCC would gather data from a variety of sources on potentially suspicious activity by broker-dealers and their customers, and forward this information to regulators.

- Education

The SEC strongly believes that an educated investor provides the best defense-- and offense--against securities fraud. Investors who know what questions to ask and how to detect fraud will be less likely to fall prey to con-artists. In addition, because they are more likely to report wrong-doing to the SEC and their state securities regulators, educated investors serve as an important early warning system to help regulators fight fraud.

Over the past 18 months, the SEC has issued several free publications that warn investors about microcap fraud and provide tips on how to invest wisely. These include:

Microcap Stock: A Guide for Investors—Released in February 1999, this brochure tells investors about microcap stocks, how to find information about companies *before* investing, what "red flags" to consider, and where to turn if they run into trouble;

Internet Fraud: How to Avoid Internet Investment Scams—Released in October 1998, *Internet Fraud* tells investors how to spot different types of Internet fraud, what the

SEC is doing to fight Internet investment scams, and how to use the Internet to invest wisely; and

Cold Calling Alert—Released in September 1997, *Cold Calling* tells investors about their legal rights, how to deal with cold calls, how to stop them, and how to evaluate investment opportunities that come over the telephone.

Investors can get these and other helpful brochures from the SEC's toll-free publications line at (800) 732-0330 or from the "Investor Assistance and Complaints" section of our Internet web site at <http://www.sec.gov>.

The SEC also reaches out to investors on both the national and grass-roots levels through investors' town meetings, our toll-free information line, the "Investor Assistance" page on our Internet Web site, and the media. For example, in the past 5 years, we've participated in 28 investors' town meetings across the country, educating investors on how to invest wisely and responding to their concerns. In the spring of 1998, the SEC and a partnership of more than 40 state and federal agencies, consumer organizations, and financial industry associations launched the "Facts on Saving and Investing Campaign," which aims to motivate Americans to get the facts they need to save, invest, and avoid financial fraud. We also work with national and regional media to ensure that as many Americans as possible hear our investor education and protection messages and learn how to reach us.

- Enforcement

The SEC has recently taken an aggressive approach to combating microcap fraud, focusing on early intervention, nationwide enforcement sweeps, and stepped up collaboration with criminal law enforcement authorities. In January and February 1999, the SEC imposed trading suspensions in fourteen microcap securities when adequate and accurate information was not available to investors. In September 1998, the SEC conducted a nationwide microcap sweep, resulting in thirteen actions against forty-one defendants involved in schemes that generated over $25 million in illegal profits. In October 1998, the SEC conducted the first nationwide crackdown on Internet securities fraud, targeting on-line promoters of microcap stocks who failed to disclose that they had received cash and stock compensation for their promotional efforts. This sweep resulted in the filing of twenty-three enforcement actions against forty-four individuals and companies. In February 1999, the SEC continued this sweep with four more enforcement actions against thirteen individuals and companies across the country. These sweep cases involved a range of illicit Internet conduct, including fraudulent spams (Internet junk mail), on-line newsletters, message board postings and web sites unlawfully touting more than 291 microcap companies.

The SEC has stepped up its collaboration with criminal authorities to conduct parallel criminal and civil investigations of microcap fraud. In 1998, the SEC assisted in an undercover sting operation conducted jointly by the Office of the U.S. Attorney for the Southern District of New York and the FBI, with assistance also from the NASD. This

undercover sting operation resulted in SEC enforcement actions against a total of eighty-seven defendants, three guilty pleas obtained by the U.S. Attorney, and five convictions at trial. The involvement of criminal law enforcement in microcap investigations sends the clear message to microcap fraudsters that the consequence of their misconduct will be more than a mere cost of doing business.

IV. CONCLUSION

Combating microcap fraud continues to be a high priority for the Commission and the SROs. We will continue working on all four prongs to further our efforts to protect investors. Since the Internet has proven to be a conducive medium for this type of fraud, our Internet efforts will likely be an integral segment of our microcap program. The accomplishments and ongoing efforts discussed in the GAO Report and above reflect this commitment.

U.S. Securities and Exchange Commission
Washington, D.C. 20549 (202) 942-0020

News Release

For Immediate Release 99-21

SEC Approves Series of Measures in Ongoing Fight Against Microcap Fraud

Washington, DC, February 19, 1999 -- In its continuing fight against microcap stock fraud, the Securities and Exchange Commission today approved a series of regulatory measures that will provide additional investor protections while fostering the capital formation process. The Commission also issued a new investor education brochure that offers tips on how to detect and avoid microcap fraud.

Taken individually, these targeted measures will increase the amount of information available to brokers and investors, close avenues that allow "pump and dump" schemes, and reaffirm the important role that investors play in protecting themselves.

Chairman Arthur Levitt said, "As more and more first time investors enter the markets and the Internet plays a greater role in people's investment decisions, the Commission continues to be vigilant in the fight against microcap fraud. Today's regulatory measures will take a bite out of microcap fraud, but investors must be a part of the solution by doing their homework, asking the hard questions, and being skeptical, especially of get-rich-quick offers they see on the Internet and elsewhere."

In February of 1998 the Commission began a comprehensive and coordinated effort to fight microcap fraud. This four-pronged effort, which includes enforcement, inspections, education and regulation, has been quite successful, yielding dozens of enforcement actions and better educated investors.

The five actions taken today by the Commission:

- Rule 504 -- Adopted amendments to Rule 504 of Regulation D that will deter microcap fraud while preserving the ability of legitimate small businesses to raise capital. Rule 504 is the limited offering exemption designed to aid small businesses raise seed capital;

- Form S-8 -- Adopted amendments to Form S-8 that will deter abuse by issuers who have shown the greatest inclination to abuse the form in the past, as well as other amendments to facilitate other intra-family transfers of securities. Also proposed additional amendments to further deter abuse. Form S-8 is a short form used to register the offer and sale of securities to an issuer's employees;

- Rule 15c2-11 -- Re-proposed amendments to Rule 15c2-11 to deter fraud in the over-the-counter market by increasing the amount of information available to brokers and investors. This rule governs the publication of quotations for securities in a medium other than a national securities exchange or the Nasdaq, such as the Bulletin Board and Pink Sheets;

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- Rule 701 -- Adopted amendments to Rule 701 to make the rule more useful and eliminate unnecessary restrictions, while preserving the protections to investors. Rule 701 allows private companies to distribute securities to their employees without filing a registration statement;

- Investor Brochure -- The Commission also released a new investor education brochure called "Microcap Stock: A Guide for Investors." The brochure, available on the Commission's website at www.sec.gov, is a primer on the world of microcap stocks and offers a variety of tips on how to detect and avoid microcap fraud. The brochure is also available in a printed booklet; to order, call (800) SEC-0330.

Nancy Smith, Director of the SEC's Office of Investor Education and Assistance, said, "While the Commission is doing all it can to detect and punish microcap scam artists, at the heart of investor protection is an educated investor. Our new booklet, 'Microcap Stock: A Guide for Investors' is a helpful 'how to' kit on understanding the microcap market, investing wisely and avoiding scams. It's a must-read for all microcap investors."

Details on the regulatory measures approved today are available at: www.sec.gov.

For more information about the SEC's four-pronged response to microcap fraud, visit the SEC's Microcap Fraud Information Center at http://www.sec.gov/news/extra/microcap.htm.

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Statement of
Chairman Arthur Levitt
Open Commission Meeting
February 19, 1999

Good morning. Today, this Commission takes a determined step forward to combat fraud and manipulation in the area of "microcap" securities. It is part of an important, far-reaching campaign to help stamp out dangerous and abusive practices in the trading and selling of low-priced stocks.

Microcap securities provide legitimate opportunities for small and new businesses to raise capital. Unfortunately, they also give the unscrupulous greater license to prey on innocent investors. The reason is straight forward: information about smaller companies is much more difficult to find and obtain than information about larger companies. And, when reliable information is scarce, the potential for fraud increases.

High-pressure cold calling, unauthorized trading in a customer's account, and stock manipulation schemes provide the means to cheat investors out of their life-savings. The Commission has undertaken a four-pronged approach to address this behavior.

First, we have intensified examinations and inspections of broker-dealers who trade in microcap securities. Second, we have increased the coordination of enforcement efforts with law-enforcement, the states and self-regulatory organizations. Third, we have implemented and continue to propose regulations to strengthen disclosure and regulatory oversight of low-priced stocks that trade in low volumes. And fourth, we have dramatically stepped-up our efforts to inform investors on what practical steps they can take to spot securities fraud.

Today's measures represent the last two areas -- regulatory oversight and investor education. Taken individually, these targeted measures will increase the amount of information available to investors, close avenues which have been exploited by some to ruthlessly and irresponsibly promote a certain stock, and reaffirm the important role that investors play in protecting themselves.

In undertaking this action, we are sensitive to any inadvertent impact it may have on the liquidity of thinly traded issues. And, I believe we are striking a balance between capital formation and investor information. This agency's mandate is to protect investors -- and stronger regulation in this segment of the market is essential to fulfilling that mission.

Teddy Roosevelt, nearly a hundred years ago stated, "We draw the line against misconduct, not against wealth." Our efforts to combat microcap fraud is a further demarcation of that line.

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There are few undeniable truths when it comes to investing in our markets. But surely one is that the best, most effective protection an investor can provide for himself is awareness. No amount of regulation -- however omnipotent or ubiquitous -- will completely replace an individual investor's power to ask questions and demand truthful answers.

In that vein, the Commission is doing everything it can to give investors the tools they need to make informed investment decisions. In addition to the regulatory initiatives taken today, we are also releasing a new investor education brochure giving investors tips on how to detect and avoid microcap fraud.

Every day, more and more Americans are investing in our markets. They invest in the hope they will be able to own a house someday, or send their child to college or retire comfortably so they won't be a burden on their families. Dishonest dealers not only undermine public confidence in the integrity of our markets, they damage the hopes and dreams of thousands of hard-working families.

Before I conclude, I want to acknowledge the staff from the Divisions of Corporation Finance, Enforcement, Market Regulation and the Office of Investor Education and Assistance for their work. These measures reflect a thoughtful effort and I thank them for their teamwork.

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Adoption of Amendments to Rule 504
Fact Sheet
2/19/99

Rule 504, the limited offering exemption under Regulation D, is designed to help small businesses raise "seed capital." Currently, Rule 504 permits non-reporting issuers to offer and sell securities to an unlimited number of persons without regard to their sophistication or experience and without delivery of any specified information. General solicitation and advertising are permitted for all Rule 504 offerings. The aggregate offering price of this exemption is limited to $1 million in any 12-month period, and certain other offerings must be aggregated with the Rule 504 offering in determining the available sales amount. Securities sold under this exemption may be resold freely by non-affiliates of the issuer.

While Regulation D offerings are exempt from federal securities registration requirements, currently these offerings must be registered in each state in which they are offered unless a state exemption is available. The vast majority of states require registration of public Rule 504 offerings. In adopting Rule 504 in 1982, the Commission placed substantial reliance upon state securities laws, since the size and local nature of these small offerings did not appear to warrant imposing extensive federal regulation. These offerings, however, continue to be subject to federal liability and civil liability provisions.

Unfortunately, since adoption of certain revisions to Rule 504 in 1992, there have been some recent disturbing developments in the secondary markets for some securities initially issued under Rule 504, and to a lesser degree, in the initial Rule 504 issuances themselves. These offerings generally involve the securities of "microcap" companies. Recent market innovations and technological changes, most notably, the Internet, have created the possibility of nation-wide Rule 504 offerings for securities of non-reporting companies that were once thought to be sold locally.

In some cases, Rule 504 has been used in fraudulent schemes to make prearranged "sales" of securities under the rule to nominees in states that do not have registration or prospectus delivery requirements. As a part of this arrangement, these securities are then placed with broker-dealers who use cold-calling techniques to sell the securities at ever-increasing prices to unknowing investors. When their inventory of shares is exhausted, these firms permit the artificial market demand created to collapse, and investors, lose much, if not all, of their investment. This scheme is sometimes colloquially referred to as "pump and dump."

The Commission will consider amendments to Rule 504 to deter these abuses yet preserve the ability of legitimate small businesses to raise capital. These amendments would establish the general principle that securities issued in a Rule 504 transaction, just like the other Regulation D exemptions, would be restricted, and would prohibit general solicitation and general advertising, unless the specified conditions for a public Rule 504 offering are met. These conditions would be:

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- the transactions are registered under a state law requiring public filing and delivery of a substantive disclosure document to investors before sale. For sales to occur in a state without this sort of provision, the transactions must be registered in another state with such a provision and the disclosure document filed in the state must be delivered to all purchasers before sale in both states; or

- the securities are issued under a state law exemption that permits general solicitation and advertising, so long as sales are made only to accredited investors as that term is defined in Regulation D.

Most Rule 504 offerings are private. Private Rule 504 offerings would still be permitted for up to $1 million in a 12-month period, under the same terms and conditions, except for the specific disclosure requirements, as offerings under Rules 505 and 506. Securities in these offerings would be restricted, and these offerings would no longer involve general solicitation and advertising.

However, the amendments to Rule 504 would leave avenues open for issuers to make less limited offerings. By focusing on state registration, review and disclosure requirements, which are generally comprehensive, legitimate small issuers could continue to access the capital markets without having to sell restricted securities.

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Adoption of Amendments to Form S-8
Information Sheet
2/19/99

Form S-8 is the short-form Securities Act registration statement for offers and sales of securities to employees. Unlike other Securities Act registration forms, Form S-8 does not contain a separate disclosure document called a "prospectus." Instead, Form S-8 relies on documents otherwise provided by the employer to satisfy the disclosure obligations of the Securities Act. This abbreviated disclosure is available for offers and sales of securities to employees because of the compensatory nature of these offerings and employees' familiarity with the company's business due to the employment relationship. In 1990, the Commission expanded the employee concept to permit Form S-8 to be used for offers and sales to consultants or advisors who provide legitimate services to the issuer that do not involve the offer or sale of securities in a capital-raising transaction.

Since adoption of the 1990 revisions, some companies have used Form S-8 improperly to compensate consultants whose service to the company is promotion of the company's securities. This practice has been used in fraudulent promotions of microcap securities. In other cases, Form S-8 has been used to distribute securities to public investors through so-called "consultants" whose service to the issuer is selling the securities. This practice, which deprives public investors of the benefits of Securities Act registration, has been the subject of several Commission enforcement actions. The Commission will consider adopting amendments to Form S-8 and related rules designed to deter these abuses. These amendments would:

- amend Form S-8 and related rules to make the form unavailable for sales to consultants and advisors who directly or indirectly promote or maintain a market for the company's securities; and

- amend Securities Act rules so that registration statements, such as Form S-8, that "go effective" automatically upon filing will not be presumed to be filed on the proper form.

The Commission also will consider proposing new amendments to Form S-8 that are designed to deter the same abuses. These proposals would amend the Form S-8 eligibility standards to:

- require any company to be timely in its Exchange Act reports during the 12 calendar months and any portion of a month before the Form S-8 is filed; and

- require a company formed by a merger of a nonpublic company into an Exchange Act reporting "shell" company to wait until it has filed an Exchange Act annual report containing audited financial statements reflecting the merger before filing a Form S-8.

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The Commission continues to consider an earlier proposal to require disclosure in Form S-8 of the names of any consultants and advisors who will receives securities under the registration statement, as well as the amount of securities to be offered to each and the nature of the consulting or advisory services, and related comment requests. The Commission has extended the comment period on these matters for the duration of the comment period on the new proposals. In the future, the Commission may adopt any combination of the earlier proposal, the related comment requests, and the new proposals.

Although Form S-8 has been misused in microcap fraud schemes, most Forms S-8 are filed for legitimate employee compensation purposes. The Commission also will consider adopting amendments that would simplify registration of securities underlying employee benefit plan stock options. Because these options have become an increasingly important component of employee compensation, employees are more likely to face circumstances - such as estate planning and property settlements in connection with divorce - that may require the transfer of options to their family members. Form S-8 appears suitable for the exercise of employee benefit plan stock options by employees' family members because of the continuing compensatory nature of the transaction. The amendments would make Form S-8 available for these exercises, and clarify how options that have been transferred to family members should be disclosed in SEC filings.

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Adoption of Amendments to Rule 701
Fact Sheet
2/19/99

In 1988, the Commission adopted Rule 701 under the Securities Act of 1933 to allow private companies to sell securities to their employees without the need to file a registration statement, as public companies do. The rule provides an exemption from the registration requirements of the Securities Act for offers and sales of securities under certain compensatory benefit plans or written agreements relating to compensation. The exemptive scope covers securities offered or sold under a plan or agreement between a non-reporting ("private") company (or its parents or majority-owned subsidiaries) and the company's employees, officers, directors, partners, trustees, consultants and advisors. The maximum extent of the Commission's authority under Section 3(b) of the Securities Act was used to exempt offers and sales of up to $5 million per year.

Currently, the amount of securities subject to outstanding offers in reliance on Rule 701, plus the amount of securities offered or sold under the rule in the preceding 12 months, may not exceed the greatest of $500,000, or an amount determined under one of two different formulas. One formula limits the amount to 15% of the issuer's total assets measured at the end of the issuer's last fiscal year. The other formula restricts the amount to no more than 15% of the outstanding securities of the class being offered. Regardless of the formula elected, Rule 701 restricts the aggregate offering price of securities subject to outstanding offers and the amount sold in the preceding 12 months to no more than $5 million.

In October 1996, Congress enacted the National Securities Markets Improvement Act of 1996 which, for the first time, gave the authority to provide exemptive relief in excess of $5 million for transactions such as these. In February 1998, the Commission proposed a number of revisions to increase the flexibility and usefulness of Rule 701, as well as to simplify and clarify the rule.

Today, the Commission will consider revisions to the rule that:

(1) remove the $5 million aggregate offering price ceiling and, instead, set the maximum amount of securities that may be sold in a year at the greatest of:
  --$1 million (rather than the current $500,000);
  --15% of the issuer's total assets; or
  --15% of the outstanding securities of that class;
(2) require the issuer to provide specific disclosure to each purchaser of securities if more than $5 million worth of securities are to be sold;
(3) do not count offers for purposes of calculating the available exempted amounts;
(4) harmonize the definition of consultants and advisors permitted to use the exemption to the narrower definition of Form S-8;
(5) amend Rule 701 to codify current and more flexible interpretations; and
(6) simplify the rule by recasting it in plain English.

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Reproposal of Amendments to Rule 15c2-11
Fact Sheet
2/19/99

PROBLEM: Quotations can be integral to fraudulent schemes involving microcap securities. Retail brokers "hyping" a microcap security may point to a market maker's quotation as indicating the security's value to a potential customer. The Commission is concerned about the role of these quotations because most market makers for unlisted securities may publish quotations without reviewing information about the issuer.

- Microcap securities often are thinly-traded and their issuers have minimal or no assets. Many of these securities trade in the unlisted over-the-counter market, i.e., they are not listed on an exchange or Nasdaq, but are quoted in systems like the NASD's OTC Bulletin Board or the National Quotation Bureau's "Pink Sheets".

RESPONSE: In February, 1998, the Commission proposed amendments to Rule 15c2-11 under the Exchange Act to require all market makers initiating quotations for unlisted securities in a quotation medium to review information about the issuer, and to review updated information annually if they are publishing priced quotations. The Commission is now reproposing amendments that are substantially similar to the original ones, but they will apply to a smaller group of securities -- ones that are more likely to be prone to fraud and manipulation. Also, the reproposal applies primarily to priced quotations. This narrowed scope responds to commenters' concerns and should reduce compliance costs.

HOW RULE 15c2-11 WORKS NOW: Rule 15c2-11 requires market makers to review basic issuer information prior to publishing quotations for that issuer's securities. Market makers must have a reasonable basis for believing that the information is accurate and from reliable sources. The Rule describes the kind of information that the broker-dealer must review.

The problem with the current Rule is that once one market maker has published quotations for a security for at least 30 days, other market makers can publish quotations for the security without reviewing any information (i.e., they can "piggyback" onto the quotes of the first market maker). Market makers then can quote indefinitely without reviewing any updated information (unless the Commission suspends trading in the security).

REPROPOSED AMENDMENTS: The reproposed amendments will require market makers to review issuer information before initiating priced quotes for unlisted securities (i.e., "piggybacking" would be eliminated). In short, they will have to "stop, look and listen" before starting to place priced quotes for an unlisted security in a quotation system.

In addition, market makers publishing priced quotations will have to review updated information annually. Market makers will also have to document their review and record information regarding any significant relationships that they have with the issuer or others, including the receipt of

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any compensation to make a market. In one respect, the reproposal does not differ from the current Rule; the first market maker to publish a quote, priced or unpriced, will have to review the specified issuer information.

The reproposal also limits the scope of the Rule to securities that are more likely to be targets of microcap fraud. Under the reproposal, market makers quoting the following securities would not have to comply with the Rule:

- securities with a worldwide average daily trading volume value of at least $100,000 during each of the six full calendar months immediately preceding the date of publication of a quotation, and convertible securities where the underlying security satisfies this threshold;
- securities with a bid price of at least $50 per share;
- securities of issuers with net tangible assets in excess of $10,000,000, based on audited financial statements; and
- non-convertible debt, non-participatory preferred stock, and investment grade asset-backed securities.

The Commission also is publishing an Appendix to the reproposal that gives guidance to broker-dealers on their review obligations under the current rule and lists "red flags" that they should look for when reviewing the issuer information under the reproposal if adopted. These red flags should alert market makers to the potential for fraud involving the issuer of the security.

The issuer information that market makers would need to review is readily available for issuers that file periodic reports with the Commission (i.e., reporting companies). For non-reporting companies, market makers would have to obtain more information than Rule 15c2-11 currently requires, including more information about the issuer's insiders, control persons and promoters and about recent significant events involving the issuer. Importantly, market makers will have to provide non-reporting issuer information to customers that request it.

The proposals generally target the unlisted securities market. By requiring all market makers to review issuer information, they may be deterred from becoming knowing or unwitting participants in fraudulent schemes.

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Mr. OXLEY. Let me now turn to our witnesses. And let me, before I begin, indicate to the media and make a note that the presentation by Mr. Fuentes of the FBI will include a sampling of court-ordered telephone wiretaps that have been collected in investigation and presented as evidence in a pending case. I understand these contain inappropriate and coarse language. So any young people or anyone who would prefer not to hear that might want to step in the hall for a few minutes when those tapes are on. Those listening on the live Webcast of this hearing on the Commerce Committee Web site and the television crews here today are similarly warned.

With that caveat, I will ask Mr. Fuentes to testify first. Let me point out that perhaps after you have given your testimony, we can hear those tapes after the other witnesses have also completed their testimony.

With those ground rules, let me now recognize Mr. Fuentes of the FBI.

STATEMENTS OF THOMAS V. FUENTES, CHIEF, ORGANIZED CRIME SECTION, CRIMINAL INVESTIGATION DIVISION, FEDERAL BUREAU OF INVESTIGATION; RICHARD H. WALKER, DIRECTOR, DIVISION OF ENFORCEMENT, SECURITIES AND EXCHANGE COMMISSION; BRADLEY W. SKOLNIK, SECURITIES COMMISSIONER, STATE OF INDIANA, PRESIDENT, NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.; AND BARRY R. GOLDSMITH, EXECUTIVE VICE PRESIDENT, NASD REGULATION, INC., OFFICE OF ENFORCEMENT

Mr. FUENTES. Thank you. Good morning, Mr. Chairman and members of the subcommittee.

I am Tom Fuentes. I am Chief of the Organized Crime Section at FBI headquarters here in Washington. I am very pleased to appear before you today to discuss the FBI's role in investigating organized crime's involvement in the financial and securities markets. The FBI investigates financial and securities fraud schemes primarily through our financial crimes white collar crime program. However, we have recently documented a willingness on the part of organized crime groups to engage more frequently in this type of criminal activity, and as a result our organized crime program has become very active and engaged in pursuing these types of investigations.

Organized crime has stepped into financial and securities frauds schemes for the same reason that it engages in any other type of criminal activity. It goes where the money is. And the bull market of the past few years with its extraordinary profits has caught the eye of organized crime. In the past approximately 8 years, organized crime's involvement in the financial and securities markets has become significant.

Historically, organized crime's role in the financial and securities markets was limited to shaking down and extorting stockbrokers who had found themselves indebted to organized crime figures for any number of reasons and attempted to work off their debts through stock manipulation. Today elements of traditional organized crime groups to include the Bonanno, Colombo, Decavalcante, Gambino, Genovese and Luchese organized crime family as well as

Eurasian organized crime groups have been linked to stock manipulation schemes. In some cases traditional Eurasian organized crime groups have worked together to infiltrate the financial and securities markets.

New technologies such as e-mail and the Internet have made it easier for organized crime to conduct these schemes. Not only can it reach a broader pool of potential victims, but the perpetrators can operate with a certain measure of anonymity. Organized crime groups target small-cap or microcap stocks or over-the-counter stocks and other types of thinly traded stocks which can be easily manipulated.

Organized crime schemes involving the financial and securities markets tend to use offshore bank accounts to conceal the conspirators' participation in the fraud scheme as well as provide a mechanism to launder the illegal proceeds of these type of fraud schemes. Thus criminal indictments tied to these schemes usually include money laundering and income tax evasion violations. Their victims tend to be elderly or inexperienced investors, and there is every reason to believe that the amount of money to be made increases more and more as this type of activity develops.

What makes the financial and securities fraud schemes appealing to organized crime is the size of profits to be made in relatively short periods of time coupled with the difficulty of detecting these schemes. The sheer amount of money involved makes it a tempting target for exploitation by organized crime.

Recently we have had a number of successful investigations and prosecutions in this area. In November 1997, after a 1-year investigation which included extensive electronic surveillance, the United States Attorney's Offices in the Southern District of New York indicted 19 defendants including a capo in the Bonanno organized crime family and a capo in the Genovese organized crime family and other organized crime associates. These individuals orchestrated an effort to gain control and influence over a brokerage firm known as Meyers, Pollock and Robbins through bribes and extortion. These defendants use their influence over the brokerage firm to manipulate the market price of Healthtech International, a small company whose stock traded on the NASDAQ small-cap market. Members and other defendants in this matter secretly obtained shares of Healthtech from its CEO in return for causing the brokerage and brokers to manipulate the price of Healthtech stock to artificially high levels. They then made substantial profits by selling their secretly obtained shares to the public at these artificially inflated prices.

As a result of these investigations, 17 of the defendants were convicted and sentenced to various prison sentences as a result.

In another investigation conducted in the Southern District of New York, 120 defendants including 11 members and associates of New York's 5 major organized crime families were charged with crimes related to the manipulation of the securities markets. This investigation, code-named Operation Uptick, centered on organized crime's involvement in a series of schemes to artificially inflate the market prices of 19 public companies and then sell to the unsuspecting public stock in those companies which was held by an investment firm known as DNM Capital, Incorporated.

The investigation also revealed organized crime's involvement in a number of fraudulent private placements of stock in several small private companies.

One other aspect of this investigation involved an effort by a Colombo organized crime associate to bribe an official for a pension fund who, in turn, would cause the pension fund to invest in a number of entities which had agreed to kick back portions of that pension fund to DMN Capital for the benefit of organized crime associates. Charges involved in this investigation are pending trial.

On March 1, 2000, after a 3-year investigation by the FBI and the New York City Police Department, 19 individuals were indicted in the Eastern District of New York on RICO charges relating to the fraudulent manipulation of securities by members and associates of the Gambino and Genovese organized crime families working with a Russian organized crime group. Among those individuals were a capo and associate in the Bonanno crime family, a soldier in the Genovese family, a soldier and associate of the Gambino organized crime family, and associates from the Colombo family. Of the 19 defendants, 17 have been charged with racketeering violations, and the investigation is ongoing.

Another investigation recently conducted in the Eastern District of New York charged 23 defendants with participating in a large-scale stock fraud and money-laundering scheme that was controlled and directed by a confederation of traditional and Russian organized crime groups. This scheme generated more than $10 million in illegal proceeds by defrauding hundreds of innocent victims who, through false and misleading high-pressure sales pitches, were induced by the defendants to invest in worthless stocks. The scheme was led by defendants and associates of the Colombo organized crime family. This investigation against other defendants is also ongoing.

Finally, the YBM Magnex case initiated by our Philadelphia office in 1996, and as part of the criminal conspiracy, YBM Magnex was formed by an individual with ties to the former Soviet Union and associated with organized criminal activity in Eastern Europe. Once formed, YBM Magnex registered its stock with securities regulators in Canada and the United States in order to sell the stock to the public in both countries.

In May 1998, agents from the FBI, Internal Revenue Service, U.S. Customs Service, Immigration and Naturalization Service and the Department of State, with assistance from the Security and Exchange Commission, executed a search warrant on the premises of YBM Magnex in Newtown, Pennsylvania, the organization's U.S. Base of financial operations. The conspirators in this investigation had engaged in a stock fraud scheme centering on YBM shares offered through the stock exchange originally in Calgary, Alberta, Canada. YBM Magnex was trading on the Toronto Stock Exchange, Ontario, Canada, as a member of the exchange's leading index of 300 companies until the time of the aforementioned raid at the Magnex office. It was then removed from the Toronto Stock Exchange after that raid.

In June 1999, YBM pleaded guilty in U.S. District Court for the Eastern District of Pennsylvania to a one-count criminal information charging a multiobject conspiracy to commit securities fraud

and mail fraud. As a part of the conspiracy YBM filed a prospectus with securities regulators at the Ontario Securities Commission for approval to issue their second public offering of its stock. The proceeds of that offering generated approximately $100 million Canadian.

Beginning in August 1996, YBM filed a series of documents with the Securities and Exchange Commission and the NASDAQ in order to obtain authorization to issue stock in the United States. It is important to note that this plea constitutes a global resolution of the criminal conduct of the corporation, the corporate defendant only, that occurred between 1993 and the date of the plea. The investigation against the individual subjects involved is ongoing at this time.

Although these investigations are financially complex, we utilize traditional investigative techniques such as the use of informants, undercover operations and electronic surveillance in developing cases suitable for prosecution. Our investigations are coordinated closely with the Securities and Exchange Commission so as to minimize losses to the investors once these schemes are uncovered. Both the SEC and the National Association of Securities Dealers have provided assistance by identifying victims, coconspirators and trading activity relative to these fraudulently manipulated stocks.

In conclusion, I want to thank the subcommittee for giving me the opportunity to testify here today. This trend toward investing in the financial markets and the tremendous profits which have been realized in recent years, as well as the sheer volume of funds involved, make the financial and securities markets prime targets for exploitation by organized crime, as organized crime goes where the money is. The FBI is fully prepared to address the emerging area of criminal activity and have already realized significant successes as well as prevented substantial financial loses. We look forward to working with the Congress to insure that we continue to meet the investigative demands of this emerging and developing aspect of organized crime.

This concludes my prepared remarks, and as the chairman mentioned, we have a tape which should wait until later on. Thank you very much.

[The prepared statement of Thomas V. Fuentes follows:]

PREPARED STATEMENT OF THOMAS V. FUENTES, CHIEF, ORGANIZED CRIME SECTION, CRIMINAL INVESTIGATIVE DIVISION, FEDERAL BUREAU OF INVESTIGATION

Good Morning, Mr. Chairman and members of the subcommittee. I am very pleased to appear before you today to discuss the Federal Bureau of Investigation's (FBI's) role in investigating organized crime's involvement in the financial and securities markets. The FBI investigates financial and securities fraud schemes primarily through our Financial Crimes Program. However, we have recently documented a willingness on the part of organized crime groups to engage more frequently in this type of criminal activity and as a result, our Organized Crime Program has become very active and engaged in pursuing these types of investigations.

Organized crime has stepped into financial and securities fraud schemes for the same reason that it engages in any other area of criminal activity-it goes where the money is and the "bull market" of the past few years, with its extraordinary profits, has caught the eye of organized crime. In the past approximately eight years, organized crime's involvement in the financial and securities markets has become significant. Historically, organized crime's role in the financial and securities markets was limited to shaking down and extorting stockbrokers who had found themselves indebted to organized crime figures, for any number of reasons, and attempted to work off their debts through stock manipulation. Today, elements of traditional or-

ganized crime groups, to include the Bonanno, Colombo, Decavalcante, Gambino, Genovese, and Luchese organized crime families, as well as Eurasian organized crime groups, have been linked to stock manipulation schemes. In some cases, traditional Eurasian organized crime groups have worked together to infiltrate the financial and securities markets.

New technologies such as E-mail and the Internet have made it easier for organized crime to conduct these stock and securities schemes. Not only can it reach a broader pool of potential victims, but the perpetrators can operate with a certain measure of anonymity. Organized crime groups target "small-cap" or "micro-cap" stocks, over-the-counter stocks, and other types of thinly traded stocks which can be easily manipulated. Organized crime schemes involving the financial and securities markets tend to use offshore bank accounts to conceal the conspirators' participation in the fraud scheme as well as provide a mechanism to launder the illegal proceeds of these type of fraud schemes. Thus criminal indictments tied to these schemes usually include money laundering and income tax violations. Their victims tend to be elderly or inexperienced investors and there is every reason to believe that as the amount of money to be made increases, more and more of this type of activity will develop. What makes the financial and securities fraud scheme appealing to organized crime is the size of the profits to be made in relatively short periods of time coupled with the difficulty of detecting these schemes. The sheer amount of money involved makes it a tempting target for exploitation by organized crime.

Recently we have had a number of successful investigations and prosecutions in this area. In November of 1997, after a one year investigation which included extensive electronic surveillance, the United States Attorney's Office in the Southern District of New York, indicted 19 defendants including Frank Lino, a Capo in the Bonanno organized crime family, Rosario Gangi, a Capo in the Genovese organized crime family, and Eugene Lombardo, an organized crime associate. These individuals orchestrated an effort to gain control and influence over a brokerage firm known as Meyers, Pollock, and Robbins through bribes and extortion. Lino, Gangi, Lombardo and the other defendants used their influence over the brokerage firm to manipulate the market price of Healthtech International, a small company whose stock traded on the NASDAQ Small-Cap market. Lombardo and the other organized crime defendants in this matter secretly obtained shares of Healthtech from its CEO, in return for causing the brokerage and its brokers to manipulate the price of Healthtech's stock to artificially high levels. They then made substantial profits by selling their secretly obtained shares to the public at artificially inflated prices. As a result of this successful investigation, 17 of the defendants were convicted to include Lino, who was sentenced to 57 months in prison, Gangi who was sentenced to 97 months in prison, and Lombardo who was sentenced to 96 months in prison. In addition, the CEO was sentenced to 87 months. In another investigation conducted in the Southern District of New York, 120 defendants, including eleven members and associates of New York's five major organized crime families, were charged with crimes related to the manipulation of the securities markets. This investigation, code-named "Operation Uptick," centered on organized crime's involvement in a series of schemes to artificially inflate the market prices of 19 public companies and then sell, to the unsuspecting public, stock in those companies which was held by an investment firm known as DMN Capital, Inc. The investigation also revealed organized crime involvement in a number of fraudulent "private placements" of stock in several small, private companies. One other aspect of this investigation involved an effort by a Colombo organized crime associate to bribe an official for a pension fund who, in turn, would cause the pension fund to invest in a number of entities which had agreed to kick-back portions of the pension funds to DMN Capital, for the benefit of the organized crime associates. Charges involved in this investigation are pending trial.

On March 1, 2000, after a three year investigation by the FBI and the New York City Police Department, nineteen individuals were indicted by the Eastern District of New York on RICO charges relating to the fraudulent manipulation of securities by members and associates of Gambino and Genovese organized crime families working with a Russian organized crime group. Among those indicted were a Capo and an associate of the Bonanno organized crime family, a Soldier in the Genovese crime family, a Soldier and an associate of the Gambino organized crime family, and an associate of the Colombo organized crime family. Of the 19 defendants, 17 have been charged with racketeering violations. This investigation is ongoing.

Another investigation, recently conducted in the Eastern District of New York, charged 23 defendants with participating in a large-scale stock fraud and money laundering scheme that was controlled and directed by a confederation of traditional and Russian organized crime groups. This scheme generated more than 10 million dollars in illegal proceeds by defrauding hundreds of innocent victims who, through

false and misleading, high-pressure sales pitches, were induced by the defendants to invest in worthless stock. The scheme was led by defendants DOMINICK DIONISIO and ENRICO LOCASIO, associates of the Colombo organized crime family, who placed and supervised crews of registered and unregistered brokers and unlicensed cold callers in boiler rooms located in the branch offices of several brokerage firms. DIONISIO was sentenced to 8 years in prison and ordered to pay 10 million dollars in restitution. LOCASIO was sentenced to 5 years in prison and ordered to pay 5 million dollars in restitution. This investigation is also ongoing.

Finally, The YBM Magnex case was initiated by our Philadelphia office in 1996. As part of a criminal conspiracy, YBM Magnex was formed by an individual with ties to the former Soviet Union and associated with organized criminal activity in Eastern Europe. Once formed, YBM Magnex registered it's stock with securities regulators in Canada and the United States in order to sell the stock to the public in both countries. In May 1998, federal agents from the FBI, Internal Revenue Service, United States Customs Service, Immigration and Naturalization Service and Department of State executed a search warrant on the premises of YBM Magnex in Newtown, Pennsylvania, one of the organization's US bases for financial operations. The conspirators in this investigation had engaged in a stock fraud scheme centering on YBM Magnex shares offered through the stock exchange in Calgary, Alberta, Canada. YBM Magnex was trading on the Toronto Stock Exchange (TSE), Ontario, Canada, as a member of the exchange's leading index of 300 companies until the time of the aforementioned raid of the YBM Magnex offices, when the TSE removed YBM Magnex from its index.

In June 1999, YBM Magnex pleaded guilty in U. S. District Court, Eastern District of Pennsylvania, to a one count criminal information charging a multi-object conspiracy to commit securities fraud and mail fraud. As part of the conspiracy, YBM Magnex filed a prospectus with securities regulators at the Ontario Securities Commission (OSC), for approval to issue a second public offering of its stock, the proceeds of which generated approximately $100 million (CDN).

Beginning in August of 1996, YBM Magnex filed a series of documents with the Securities and Exchange Commission (SEC) and the NASDAQ to obtain authorization to issue stock in the U. S. It is important to note that this plea constitutes a global resolution of all criminal conduct involving the *corporate defendant only,* that occurred between 1993 and the date of the plea. The YBM investigation is ongoing.

Although these investigations are financially complex, we utilize traditional investigative techniques such as the use of informants, Undercover Operations, and electronic surveillance in developing cases suitable for prosecution. Our investigations are coordinated with the Securities and Exchange Commission (SEC) so as to minimize losses to the investors once these schemes are uncovered. Both the SEC and the National Association of Securities Dealers (NASD) have provided assistance by identifying victims, co-conspirators, and trading activity relative to these fraudulently manipulated stocks.

Conclusion

I want to thank the subcommittee for giving me the opportunity to testify here today. The trend towards investing in the financial markets and the tremendous profits which have been realized in recent years as well as the sheer volume of funds involved make the financial and securities markets prime targets for exploitation by organized crime, as it goes where the money is. The FBI is fully prepared to address this emerging area of criminal activity and have already realized significant successes as well as prevented substantial financial losses. We look forward to working with Congress to ensure that we continue to meet the investigative demands of this emerging and developing aspect of organized crime. This concludes my prepared remarks. I would like to respond to any questions that you may have.

Mr. OXLEY. Thank you, Mr. Fuentes.

Mr. Walker from the SEC, Chief of the Enforcement Division. Thank you, and welcome back.

STATEMENT OF RICHARD H. WALKER

Mr. WALKER. Good morning. Thank you, Chairman Oxley. Good morning, members of the subcommittee.

I am Richard Walker, the SEC's Director of Enforcement. I appreciate the opportunity to testify today on behalf of the Securities and Exchange Commission concerning the involvement of organized crime on Wall Street. This issue, though not new, has re-

ceived heightened attention in the past several years as reported Mob involvement on Wall Street has increased. The increase is likely the confluence of two different factors. First, the Mob is being driven from certain of its traditional havens such as garbage hauling cartels. And second, as previously noted, the longest-running bull market in our Nation's history has created new opportunities for illegal profits.

Based on Commission efforts in combatting illegal conduct in our markets, we believe three conclusions can be stated at the outset. First, organized crime activity on Wall Street does not threaten the overall integrity of our Nation's securities markets. Second, such activity has been confined to the microcap sector of the securities market, a market for low-priced, thinly traded securities, and Mob activity taints only a small fraction of that sector. And third, aggressive civil and criminal law enforcement actions attacking microcap fraud have shut the doors of some of the most notorious boiler rooms which provide a point of entry to the securities markets for organized crime.

While Hollywood has sensationalized organized crime on Wall Street during the past year by making it the story line of various movies and television shows, the Commission, not surprisingly, finds little entertainment value in the subject. Rather, the Commission believes that any unlawful activity by organized crime on Wall Street is cause for serious concern and requires the strongest possible response by law enforcement.

The Commission employs a two-prong plan for fighting organized crime: Vigorous enforcement efforts plus regulatory initiatives designed to safeguard the microcap market and eliminate some of the abusive practices that have plagued that market.

I would like to use my remaining minutes to highlight some of our achievements in each of these areas. The Commission has worked closely with the FBI, various United States Attorneys' Offices, State and local prosecutors and regulators, and the NASDR to bring a number of significant enforcement actions in recent years targeting fraudulent practices in the microcap market, particularly stock manipulations. In a number of these cases, charges have been asserted against members of organized crime. These joint prosecutions have been highly successful, and we will continue to make sure that each and every instance of organized crime on Wall Street is vigorously prosecuted.

The key to success in this area is close cooperation among both civil and criminal regulators and prosecutors. The reasons are several. First, members of organized crime are not deterred by civil sanctions alone. They view injunctions and money penalties as costs of doing business. Rather, the threat of jail time is the most effective deterrent in this area. Second, civil regulators and criminal prosecutors each possess unique expertise that is necessary to root out the involvement of organized crime on Wall Street. The SEC, NASDR and other regulators surveil our capital markets and identify suspicious trading activity. We react quickly to red flags that securities fraud is occurring, such as unexplained surges in stock price and spikes in trading volume.

If our investigation turns up potential involvement by organized crime, we immediately telephone our colleagues at the Justice De-

partment or the FBI. The Justice Department, U.S. Attorneys and FBI have great expertise in surveilling organized crime. They do so through a variety of means not available to civil regulators, including electronic surveillance and undercover operations. We assist criminal authorities by conducting parallel civil investigations, providing substantive expertise to the criminal authorities, and even detailing members of our staff to various U.S. Attorneys' offices to work on these cases and to help with the prosecutions.

These joint efforts have paid substantial dividends. We have partnered with the U.S. Attorneys' Offices for the Southern and Eastern Districts of New York, the FBI, NASDR, and our State counterparts to prosecute some of the most notorious boiler rooms and associated underworld figures. There have been nine major actions attacking organized crime on Wall Street in the last 3 years alone. These cases included charges against at least 30 defendants who are specifically alleged to have ties to the major crime families.

Of particular value have been recent undercover "sting" operations. For example, on June 14, 2000, the SEC, United States Attorney for the Southern District of New York, FBI, and NASDR jointly announced the results of a 1-year undercover operation targeting microcap fraud, including fraud perpetrated by organized crime operating in this market. The results were eye-opening. The SEC sued 63 individuals and entities in five enforcement actions. The U.S. Attorney's Office indicted 120 defendants, including 11 members and associates of 5 organized crime families, in connection with several securities fraud scams. The indictments allege an array of microcap manipulations and private placement frauds.

The sentences handed down in recent securities fraud cases against members of organized crime should send a strong message that this behavior will not be tolerated. Three members of organized crime were sentenced just last week on September 7 in the Eastern District of New York for their role in several stock manipulations. Prison terms for the three were 97 months, 63 months and 60 months.

Working with the NASDR and Federal and State authorities, we have made tremendous advances in shutting down some of the most notorious boiler rooms, including: Sterling Foster, Stratton Oakmont, A.S. Goldmen and A.R. Baron. Other boiler rooms have also closed in the face of regulatory pressure. They include Hanover Sterling, Monroe Parker, Kensington Wells, Duke and Company, Biltmore Securities, the list goes on and on.

We have also collectively charged both civilly and criminally some of the most notorious individuals who operate in this market, including: Robert Brennan of First Jersey Securities, Andrew Bressman and Roman Oken of A.R. Baron, Jordan Belfort and Daniel Porush of Stratton Oakmont, and Adam Lieberman and Randolph Pace of Sterling Foster. I am pleased to report that Randolph Pace, a seasoned boiler room operator, pled guilty to 13 felony counts this past Friday and will be sentenced on December 21.

These collective efforts have had a major impact in curbing microcap fraud and have helped to rid the microcap market of destructive influences. And if potential manipulators migrate to the

Internet in the wake of these boiler rooms, they will quickly find that we have a vigilant enforcement program there as well.

Finally, we have supplemented our enforcement efforts to safeguard the microcap market with regulatory efforts. Our experience shows that the most frequent form of securities fraud committed by organized crime is the "pump and dump" manipulation of low-priced securities. The scheme centers on the spreading of false information—principally either through a boiler room or the Internet—to inflate a stock's price. The manipulators then sell their stock that they have amassed for little or nothing at an inflated price to innocent investors. The spreading of lies then ceases, and the stock price generally collapses.

An effective pump and dump scheme requires that those committing the fraud be able to quickly and cheaply obtain a supply of stock that can be manipulated. Our rulemakings in this area have created obstacles for manipulators seeking to obtain stock while at the same time not unduly hampering legitimate capital-raising efforts by small businesses.

On behalf of the Commission, we appreciate your interest in this very important issue. Our Nation's securities markets have long enjoyed a reputation as the safest and fairest in the world. We cannot and will not allow that reputation to be tarnished by organized crime. We have done much to prevent that and are firmly committed to continuing these efforts in the future. As always, we stand ready to assist the subcommittee as it goes forward in addressing this issue. Thank you.

[The prepared statement of Richard H. Walker follows:]

PREPARED STATEMENT OF RICHARD H. WALKER, DIRECTOR, DIVISION OF ENFORCEMENT, UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Chairman Oxley, Ranking Member Towns, and Members of the Subcommittee: I appreciate the opportunity to appear before this Subcommittee on behalf of the Securities and Exchange Commission ("SEC" or "Commission") to address the involvement of organized crime on Wall Street and the Commission's efforts to end this involvement. The Commission commends the Chairman, the Ranking Member, and the Members of the Subcommittee for holding hearings on this important topic. These hearings are particularly timely in light of the announcement this past June by the SEC, the United States Attorney's Office for the Southern District of New York, the FBI, and NASD Regulation of a major strike against organized crime on Wall Street. Over 100 individuals were indicted, including 11 members and associates of five different organized crime families.

I. EXECUTIVE SUMMARY

The government has charged affiliates of organized crime families with securities law violations in several recent cases. While any unlawful activity by organized crime on Wall Street is cause for concern, the Commission believes such activity to be limited and not a threat to the overall integrity of our nation's securities markets. The Commission's experience shows that the activities of organized crime have been confined to the "microcap" securities market[1] and taint only a small fraction of that sector. Moreover, through joint prosecutions with various United States Attorney's Offices and state and local prosecutors, as well as the adoption of regulatory initiatives designed to safeguard the microcap market, the Commission has made significant strides in curtailing organized crime activity on Wall Street.

This testimony is designed to provide the Subcommittee with (i) a chronological account of enforcement actions by the SEC and other law enforcement and regulatory bodies in response to reported organized crime activity on Wall Street; and

[1] Although "microcap" is not a term defined in the federal securities laws, microcap companies are generally thinly capitalized companies whose securities trade in the over-the-counter market, primarily on the OTC Bulletin Board or in the pink sheets.

(ii) a summary of the recent regulatory initiatives designed to protect the microcap market from fraud.

II. A CHRONOLOGICAL ACCOUNT OF REPORTED MOB INVOLVEMENT ON WALL STREET AND THE RESPONSE BY REGULATORS

Mob involvement on Wall Street is not new. As organized crime advanced into the white-collar arena, the stock market became one of its targets.[2] Indeed, there is evidence that organized crime had made inroads on Wall Street back in the 1970's.[3] Then, as now, organized crime reportedly focused its efforts on the manipulation of microcap stocks.[4]

During the last 20 years, the government has brought a number of significant cases against organized crime figures operating on Wall Street. The SEC assisted criminal prosecutors in virtually all of the investigations leading to these actions. In some of these cases, the SEC did not bring separate civil actions in order to avoid the risk of impairing a parallel criminal proceeding.[5] The risk stems from the defendant's right to discovery in the SEC's civil action, which would be unavailable in a criminal proceeding. Criminal prosecution of organized crime figures takes priority over civil prosecution because most such defendants are not going to be deterred by civil sanctions alone. Rather, the threat of jail time is the most effective deterrent in this area.[6]

The most notable case brought during the 1980's that named defendants having alleged links to organized crime was a joint action by the SEC and the U.S. Attorney's Office for the District of New Jersey on October 2, 1986. This action, against Marshall Zolp, Lorenzo Formato, and others, alleged that the defendants manipulated the stock of Laser Arms Corp, a purported maker of a self-chilling can.[7] In fact, Laser Arms was a complete fraud. The company generated fictitious financial statements and the product was non-existent. Zolp was reportedly recruited by organized crime to conduct penny-stock manipulations, including the Laser Arms manipulation.[8] Co-defendant Formato testified in Congressional hearings that during the years he promoted and sold penny stocks, he was involved in organized crime.[9] Formato also testified to rampant penny stock manipulation by organized crime.[10] The Congressional hearings at which Formato testified led to passage of the Penny Stock Reform Act of 1990.[11]

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[2] *James Cook, The Invisible Enterprise,* Forbes, Sept. 29, 1980 at 60 ("As its power, experience and cash flow have mounted, organized crime has advanced into increasingly sophisticated areas—into white-collar crime like . . . the securities business.").

[3] One of the earliest reported securities fraud cases involving organized crime came on November 18, 1970 when the U.S. Attorney for the Southern District of New York and the SEC jointly announced indictments against Michael Hellerman, John Dioguardi, Vincent Aloi and others for securities fraud. Lit. Rel. No. 4826, 1970 SEC LEXIS 959 (Nov. 18, 1970). As reported in the 1980 Forbes article, Hellerman, who entered the witness-protection program, was a corrupt stockbroker manipulating several stocks, including Imperial Investments, with assistance from Dioguardi and Aloi, who allegedly had connections to organized crime. A 1977 book details the exploits of Michael Hellerman. Wall Street Swindler, 1977 at 2 ("I had been manipulating stocks for years. Some of Wall Street's biggest swindles, frauds that had ripped off millions of dollars from brokerage houses and banks, had been my brainchild. In most of those frauds, the mob and some of its most notorious members had been my partners.").

[4] *Forbes, supra* note 2 ("[O]rganized crime would logically move into areas where there is the least regulation—the over-the-counter market, shell companies, unregistered securities—companies with less than $1 million in assets and fewer than 500 stockholders.").

[5] In addition, the SEC lacks the tools that Congress has given the Justice Department to fight organized crime. For example, the Justice Department has authority to conduct wire taps and engage in undercover operations. The SEC, on the other hand, is subject to the Privacy Act of 1978, which requires SEC staff to identify themselves when seeking information from witnesses. In addition, Federal Rule of Criminal Procedure 6(e) generally prevents the Justice Department from sharing grand jury materials with the SEC, though the SEC immediately notifies the Justice Department of a matter if we suspect organized crime involvement.

[6] *See Bud Newman, Fraud, Organized Crime Said Rampant in "Penny Stock" Market,* UPI, Sept. 8, 1999 (quoting Congressional testimony of Lorenzo Formato, an admitted penny stock manipulator with ties to organized crime: "Jail . . . is one of the biggest deterrents to what is going on in the industry today.").

[7] *U.S. v. Zolp,* Lit. Rel. No. 11236, 1986 SEC LEXIS 635 (Oct. 2, 1986).

[8] *Securities Investigators Get a Handle on the Mob,* The Toronto Star, Feb. 26, 1989 at F2.

[9] *See Witness Tells of Mob Influence in Penny Stocks,* Los Angeles Times, Sept. 8, 1989 at B2.

[10] *Id.*

[11] Congressional passage of the Penny Stock Reform Act of 1990 helped curb fraud in the penny-stock market (a sub-group of the larger microcap market, and generally defined as stocks trading at $5 or less). Among other things, this Act requires a broker-dealer to disclose its compensation on all penny stock trades, provide a risk disclosure statement to all penny stock cus-

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Next, on December 13, 1988, the SEC sued F.D. Roberts Securities, Inc., a New Jersey boiler room, and four associated persons for manipulating a microcap stock, Hughes Capital Corp. At least one of the four individuals sued, Dominick Fiorese, an F.D. Roberts consultant, had reported ties to organized crime.[12]

Mob activity on Wall Street reportedly increased in the 1990's. On February 10, 1997, *The New York Times* reported that "Mafia crime families are switching increasingly to white-collar crimes" with a focus on "small Wall Street brokerage houses."[13] According to *The New York Times* story, the Mafia's entry into the securities markets was spurred by its reported loss of $500 million a year in profits from the dissolution of its garbage-hauling cartels, and its reported loss of $50 million a year in profits following its eviction from the Fulton Fish Market.[14] Around the time of *The New York Times* story, *Business Week* also ran a cover story entitled, "The Mob on Wall Street."[15] Several of the individuals and entities mentioned in the story were then the subject of SEC and criminal investigations.

A series of criminal indictments and civil prosecutions of several securities law violators with alleged connections to organized crime began in 1997.[16] In May 1997, a FBI sting operation led to charges by the U.S. Attorney for the Eastern District of New York against Louis Malpeso, Jr., a reported Colombo crime family associate, for conspiring to commit securities fraud.[17] The indictment alleged that Malpeso conspired with stock broker Joseph DiBella and Robert Cattogio, one of the heads of the Hanover Sterling brokerage firm, to inflate the price of a penny stock, First Colonial Ventures. The Business Week Article had reported that organized crime was manipulating First Colonial stock and warned legitimate market makers to steer clear of the stock. The indictment alleged that Malpeso offered an undercover FBI agent posing as a money manager a kickback of 25 percent in exchange for the agent purchasing $2.5 million of First Colonial stock. All three defendants pled guilty.[18]

A major strike against organized crime on Wall Street came on November 25, 1997 when the U.S. Attorney for the Southern District of New York indicted 19 persons, including four with alleged ties to organized crime, for racketeering. The charges stemmed from a year-long investigation by the SEC, the U.S. Attorney's Office, the FBI, and the New York Police Department with the assistance of NASD Regulation. The 25-count indictment outlined the infiltration of a brokerage firm,

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tomers, and provide a monthly statement to clients disclosing the market value of all penny stocks in their accounts.

[12] *See Claire Poole, Good-Bye, Fellas,* Forbes, March 18, 1991 at 10 (stating that Fiorese had ties to the Gambino and Colombo crime families).

[13] *Selwyn Raab, Officials Say Mob is Shifting Crimes to New Industries,* The New York Times, Feb. 10, 1997 at A1.

[14] *Id.*

[15] *Gary Weiss, The Mob on Wall Street,* Business Week, December 16, 1996 [the "Business Week Article"]. The Business Week Article reported: (i) the mob had established a network of stock promoters, securities dealers, and boiler rooms to engage in "pump and dump" manipulations; (ii) four organized crime families (as well as elements of the Russian mob) controlled approximately two dozen broker-dealers; (iii) the mob was engaging in Regulation S scams; (iv) the mob's activities were confined to the OTC Bulletin Board and Nasdaq Small-Cap markets (the article found no indication of mob exploitation on the NYSE and AMEX); (v) the Hanover Sterling brokerage firm was under the control of the Genovese crime family; and (vi) mob-linked short sellers were associated with the Stratton Oakmont brokerage firm.

[16] Two notable law enforcement actions were taken in the early half of the 1990's. First, on November 15, 1993, Eric Wynn and four others were indicted in the District of New Jersey for conspiracy to commit securities fraud based on numerous penny stock manipulations. A jury found Wynn guilty and he was sentenced to 52 months imprisonment. Wynn was reportedly an associate of the Bonanno crime family.

Second, in 1994, the SEC sued a public issuer, Atratech, Inc., and several affiliated persons, including Anthony Gurino, for securities fraud. The Commission charged that: "Gurino secretly controlled Atratech to circumvent bars that were imposed on Gurino by New York City and the federal government prohibiting Gurino from bidding for municipal works contracts. In 1986, the City barred Gurino and his plumbing company, Arc Plumbing and Heating Co., because of their failure to disclose in a bid application that Gurino had been indicted for obstruction of justice in connection with an organized crime prosecution. During the hearing which led to the bar, Gurino was cited for failing to cooperate with the City and produce as a witness John Gotti, the head of the Gambino crime family and an alleged 'salesman' for Arc." *SEC v. Atratech,* Lit. Rel. No. 14201, 1994 SEC LEXIS 2631 (Aug. 22, 1994). A judgment by default has been issued against Atratech. Lit. Rel. No. 14862, 1996 SEC LEXIS 981 (April 4, 1996). Gurino settled the matter by agreeing to an injunction, $25,000 civil penalty, and a bar preventing him from serving as an officer or director of a public reporting company. Lit. Rel. No. 15529, 1997 SEC LEXIS 2129 (Oct. 7, 1997).

[17] *See Helen Peterson, Mafioso Held in Stock Fraud,* N.Y. Daily News, May 3, 1997 at 12. Malpeso pled guilty on February 5, 1998.

[18] Malpeso was sentenced to 18 months imprisonment.

Meyers Pollock & Robbins, by the Bonanno and Genovese crime families for the purpose of manipulating the stock price of HealthTech International. Alleged Bonanno captain Frank Lino and alleged Genovese captain Rosario Gangi caused numerous Meyers Pollock brokers, through bribes and intimidation, to artificially drive up HealthTech's stock price. The brokers were paid excessive commissions for selling this stock, and often used high-pressure sales tactics and made misrepresentations about HealthTech. An associate of Lino and Gangi had received thousands of shares of HealthTech stock from HealthTech's CEO Gordon Hall in exchange for their efforts to inflate its price.

The SEC suspended trading in HealthTech on November 17, 1997. On January 21, 1999, Lino, Gangi, and Eugene Lombardo, an alleged Bonanno family associate, pled guilty to securities fraud.[19] John Cerasini, an alleged Bonanno soldier, pled guilty to an extortion conspiracy charge. On May 11, 1999, a federal jury found Hall guilty of racketeering.[20] In addition, in April 2000, Michael Ploshnick, Meyers Pollock's President, and 11 brokers were indicted for their role in the fraud.

At the time, the HealthTech case was the largest law enforcement action taken against organized crime operating on Wall Street. Despite the size of the case, law enforcement officials cautioned that, based on their experience, they did not believe the problem to be widespread.[21]

Also during 1997, the Manhattan District Attorney's Office, working with the NASD, arrested 53 people in a broker licensing test-taking scandal. More than 50 stockbrokers were charged with paying two impostors to take their licensing tests. The brokers worked at several boiler rooms including some with alleged ties to organized crime.[22]

On April 23, 1998, the Commission sued Sovereign Equity Management Corp. and its president Glen T. Vittor for a scheme to manipulate the market price of two microcap companies, Technigen Corp. and TV Communications Network, Inc. Five days later, Vittor was separately charged by the SEC for his role in another microcap manipulation. The Business Week Article reported that Sovereign was controlled by organized crime.

On December 16, 1998, the U.S. Attorney for the Eastern District of New York charged seven people, including Robert Cattogio and Dominick Froncillo, who was alleged in the indictment to be an associate of the Genovese crime family, with a multi-million dollar stock manipulation and money laundering scheme. The scheme was carried out through a New Jersey brokerage firm, Capital Planning Associates, Inc. According to the charges, Capital Planning was under the secret control of convicted stock swindler Catoggio, who used the firm as a vehicle to carry out a series of stock manipulations. Catoggio was barred from the securities industry by the SEC in 1995 as a result of securities fraud at another brokerage firm under his control.

The stock that was the subject of the manipulation was Transun International Airways, Inc. ("TSUN"), which traded on the Nasdaq OTC electronic bulletin board stock market. According to the indictment, TSUN purported to be a chartered airline; however, it never owned or operated any planes, never conducted any airline business, and never generated any revenues. The defendants were charged with gaining control of the company's stock at minimal cost, artificially inflating its price by touting it aggressively at Capital Planning and issuing spurious claims about the health of the fly-by-night company, and then unloading over $8 million worth of

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[19] Lino was sentenced to 49 months imprisonment, Gangi to 97 months imprisonment, and Lombardo to 96 months imprisonment.

[20] The SEC detailed a member of its staff to the U.S. Attorney's Office to assist in the prosecution of this action. Recognizing the value of criminal prosecution of organized crime efforts on Wall Street, the SEC has detailed members of its staff to U.S. Attorney's Offices in other cases as well. For example, one of the lead prosecutors in the Hall case was detailed from the SEC's Northeast Regional Office to the U.S. Attorney's Office for the Southern District of New York.

[21] *See Sharon Walsh, Mob Bust on Wall Street,* International Herald Tribune, Nov. 27, 1997 at 3 (quoting Mary Jo White, U.S. Attorney for the Southern District of New York, as stating that attempts by organized crime to invade Wall Street were "relatively isolated and do not threaten the overall stability of the market"); *Richard Tomkins, Mob Linked to Pump and Dump Scheme,* The Financial Post, Nov. 29, 1997 at 24 (quoting then-SEC Enforcement Director William McLucas: "I would be very cautious about coming to any conclusion to the effect that organized crime in the securities markets, including the small capitalization and micro-capitalization markets, is rampant. I do not believe that's the case.").

[22] *See Barbara Ross & Douglas Feiden, Sting Nets Bad Stock,* N.Y. Daily News, Jan. 9, 1997 at 6 ("The brokers worked at 17 small and medium-sized brokerage firms, including three companies that reportedly have links to the Genovese crime family. The firms include Stratton Oakmont; and Hanover Sterling & Co.").

stock on unsuspecting customers. Froncillo, as well as four other defendants, plead guilty to the charges.[23]

The next major strike against organized crime on June 16, 1999 when the U.S. Attorney for the Eastern District of New York indicted 89 persons for engaging in microcap "pump and dump" manipulations at eight brokerage firms that defrauded investors out of more than $100 million. The SEC assisted in the investigation, including detailing a staff member to the Eastern District.

In one 23-defendant case, the three defendants who were charged with leading the scheme reportedly had ties to organized crime: Dominick Dionisio (Colombo family), Enrico Locascio (Colombo family), and Yakov Slavin (associate of the Bor organized crime group of Russian immigrants). Each has pled guilty.[24]

The indictment alleges that "[t]he Colombo Organized Crime Family of La Cosa Nostra controlled boiler rooms at brokerage firms that engaged in fraudulent schemes to sell securities to the public on the basis of false and misleading statements and omissions." Specifically, the indictment charges that Dionisio, Locascio, and Slavin placed and supervised registered and unregistered brokers and cold callers at several boiler rooms. The criminal enterprise allegedly manipulated several microcap stocks.

The U.S. Attorney for the Eastern District of New York, with the assistance of the SEC, also brought criminal charges on June 16, 1999, against 55 defendants for their participation in fraud at a network of four related brokerage firms. The lead defendants, Robert Catoggio and Roy Ageloff, were alleged to be the heads of the Hanover Sterling firm, the Norfolk Securities firm, PCM Securities, and Capital Planning, which operated in New York, New Jersey and Florida, and employed hundreds of brokers.

The defendants were charged with securities fraud in connection with a vast "pump and dump" manipulation that involved at least 17 OTC Bulletin Board and Nasdaq Small Cap stocks and resulted in over $100 million in fraud losses. The charges included not just securities fraud and money laundering, but an unusual use of RICO charges in connection with Catoggio's and Ageloff's operation of this enterprise. Ageloff, who recently pled guilty to the RICO charge, was the focus of the Business Week Article, in which he and Hanover Sterling were alleged to have ties to the Genovese crime family. Catoggio was charged with running the RICO enterprise with Ageloff, and had pled guilty to conspiring with Malpeso, Jr., an alleged Colombo family associate, in connection with an FBI sting. To date, 48 of the 55 defendants charged have pled guilty, with seven awaiting trial.

The next day, June 17, 1999, in an unrelated action in federal district court in Tampa, Philip Abramo, a captain of the DeCalvacante organized crime family, Louis Consalvo, a member of the DeCalvacante family, and three others were criminally charged for their role in numerous microcap "pump and dump" frauds. The indictment alleged that the defendants, through a brokerage firm previously sued by the SEC, Sovereign Equity Management Corp., solicited corporations in need of capital to conduct initial public offerings and Regulation S offshore offerings. The defendants obtained discounted stock of the issuers. The stock was then manipulated in "pump and dump" schemes run through Sovereign. Brokers at Sovereign were paid excessive commissions to "push" the stock on investors and were instructed not to permit retail customers to sell the stock, thereby keeping its price artificially propped up.

In addition, the defendants would "short" the stocks once they instructed Sovereign brokers to cease their "pumping" efforts. This would allow the defendants to make an additional profit as the price of the stock declined. A short seller must borrow the shares that he is selling short. The indictment alleged that "[w]hen the defendants could not find stock to borrow and sell 'short'. . . the defendants engaged in extortion of other brokers in order to obtain the stock using their stated relationship to the 'mafia' and also using threats to commit bodily harm."

Violence turned the public's attention to possible organized crime involvement within the securities markets on October 26, 1999. Stock promoters Maier S. Lehmann and Albert Alain Chalem were found shot to death execution style in a home in Colts Neck, New Jersey. At the time, Lehmann and Chalem ran an Internet web site, Stockinvestor.com, which touted penny stocks. The SEC had previously sued Lehmann for his role in a penny stock manipulation. Chalem had been a broker at A.S. Goldmen, a now-defunct boiler-room operation that has been the subject of both civil and criminal securities fraud charges. While no one has been charged yet in

[23] Froncillo was sentenced to 21 months imprisonment.

[24] Dionisio was sentenced to 97 months imprisonment, Locascio to 63 months imprisonment, and Slavin to 60 months imprionment.

the murders, media reports have cited close ties between Chalem and organized crime.[25]

Another major strike against organized crime in the securities markets came on March 3, 2000 when the U.S. Attorney for the Eastern District of New York indicted 19 people, including six with alleged ties to organized crime. The indictment alleged that a broker-dealer, White Rock Partners (later renamed State Street Capital Markets), working with brokers at several notorious boiler rooms, including J.W. Barclay & Co., A.R. Baron & Co., and D.H. Blair, engaged in microcap "pump and dump" manipulations. The indictment also alleged that the defendants most frequently relied on fraudulent Regulation S offerings to obtain their inventory of stock to manipulate. The six alleged organized crime members in the criminal enterprise are as follows:

Name	Position	Organized Crime Family
Frank Coppa Sr.	Captain	Bonanno
Edward Garafola	Soldier	Gambino
Eugene Lombardo	Associate	Bonanno
Ernest Montevecchi	Soldier	Genovese
Daniel Persico	Associate	Colombo
Joseph Polito Sr.	Associate	Gambino

The indictment alleges that the organized crime defendants, among other things, (i) resolved disputes relating to the hiring and retention of brokers, (ii) halted attempts by other members of organized crime to extort members of the criminal enterprise, and (iii) halted efforts to reduce the price of securities underwritten by White Rock and State Street through such techniques as short selling.

The most recent law enforcement action against organized crime on Wall Street came on June 14, 2000. The SEC, U.S. Attorney for the Southern District of New York, FBI, and NASD Regulation jointly announced the results of a one-year undercover operation targeting microcap fraud, including organized crime operating in this market. The SEC sued 63 individuals and entities in five enforcement actions. The U.S. Attorney's Office indicted 120 defendants, including 11 members and associates of five different organized crime families, in connection with several securities fraud scams conducted through various criminal enterprises. The indictments allege fraud in connection with the publicly traded securities of 19 companies and the private placement of securities of an additional 16 companies. The 11 alleged members and associates of organized crime are as follows:

Name	Position	Organized Crime Family
John M. Black	Associate	Luchese
James F. Chickara	Associate	Colombo
Robert P. Gallo	Associate	Genovese
Michael T. Grecco	Associate	Colombo
James S. LaBate	Associate	Gambino
Vincent G. Langella	Associate	Colombo
Robert A. Lino	Capo	Bonanno
Frank A. Persico	Associate	Colombo
Salvatore R. Piazza	Associate	Bonanno
Sebastian Rametta	Associate	Colombo
Anthony P. Stropoli	Soldier	Colombo

The indictments allege that the criminal enterprises engaged in the following illegal conduct:

- The manipulation of numerous microcap stocks.
- To further its manipulations, the enterprises infiltrated and gained control of certain brokerage firms, including Monitor Investment Group, Meyers Pollock & Robbins, and First Liberty Investment Group.
- To control the supply of stock that it was manipulating, the enterprises bribed brokers at other firms to "put away" (i.e, ensure their clients held) certain securities. The bribed brokers included a crew of brokers working for William Scott & Co., principals of a Meyers Pollock branch office, and a crew of brokers from Atlantic General Financial Group.
- The enterprises engaged in numerous private placement frauds, including offerings involving Ranch*1 Inc., World Gourmet Soups, and Jackpot Entertainment

[25] *See Diana B. Henriques, A Brutal Turn in Stock Frauds,* N.Y. Times, Nov. 2, 1999 at B1.

Magazine, Inc. Here, members and associates of the enterprise dominated and controlled each of the issuers. Brokers selling the securities were paid undisclosed exorbitant sales commissions of up to 50 percent. The enterprises profited by retaining a portion of the excessive sales commissions for itself.

- The enterprises engaged in a union pension fund fraud and kickback scheme. The enterprise devised two fraudulent investments that appeared to be suitable for the pension funds, but would secretly divert a portion of the investment proceeds. For example, in one corrupt offering, $2 million of every $10 million invested was to be "kicked back" to the enterprises and corrupt union officials.
- The indictment also charged that the enterprise used extortion, threats and intimidation to further its securities frauds. Specifically, the enterprises instilled fear in brokers and other market participants who did business with the enterprises, in particular those brokers who agreed to "put away" stock.

Simultaneous with the filing of the criminal indictments, the SEC instituted civil administrative proceedings against several of the criminal defendants with alleged ties to organized crime, including Black, Gallo, Grecco, LaBate, and Piazza. NASD Regulation had previously filed a complaint against 18 persons and Monitor Investment Group for fraud-related activities arising out of Monitor's activities.

Organized crime often either infiltrates or otherwise employs the assistance of "boiler room" operations to commit manipulations. The SEC and other regulators have brought significant enforcement actions against a number of notorious boiler rooms in recent years. These include:[26] A.R. Baron & Co.; Baron's president Andrew Bressman, seven Baron registered representatives; Stratton Oakmont; three Stratton principals—Jordan Belfort, Daniel Porush, and Kenneth Greene; nine Stratton registered representatives; several Meyers Pollock registered representatives; Sterling Foster & Co.; over 20 Sterling Foster registered representatives, including its president Adam Lieberman; A.S. Goldmen & Co.; A.S. Goldmen's president, Anthony J. Marchiano and its financial and operations principal, Stuart E. Winkler; five A.S. Goldmen registered representatives; several D.H. Blair registered representatives; HGI Securities and 13 of its registered representatives; M. Rimson & Co. and several Rimson registered representatives including its president Moshe Rimson; Biltmore Securities and seven Biltmore registered representatives; F.N. Wolf & Co; Hibbard Brown & Co.; several registered representatives associated with J.T. Moran & Co. and its predecessor firms (First Jersey Securities, Inc. and Sherwood Capital Group); Blinder Robinson & Co. and its president Meyer Blinder; Rooney, Pace Inc. and its president Randolph K. Pace; First Jersey Securities, Inc. and its president Robert E. Brennan; Wellshire Securities and several of its registered representatives; Investors Associates, Inc. and its president Lawrence J. Penna; J.S. Securities and its president Jeffrey Szur; La Jolla Capital Corp. and several of its registered representatives; and several Barron Chase Securities Inc. registered representatives.

In addition, Hanover Sterling ceased doing business in February 1995 when it fell out of compliance with net capital requirements after a group of outside investors began aggressively short selling Hanover's house stocks. At the time, Hanover Sterling was the subject of regulatory investigation. Meyers Pollock closed down in 1997 in the face of regulatory investigation.[27] In July 2000, D.H. Blair & Co., already defunct, and 15 of its officers and directors were indicted by the Manhattan District Attorney's Office on charges that the firm was run as a criminal enterprise.

III. REGULATORY INITIATIVES DESIGNED TO PROTECT THE MICROCAP MARKET

Existing evidence indicates that organized crime activity on Wall Street has been limited to the microcap market. The reasons for this are several. Effective market manipulations require control of the sell side of the market and keeping the truth about the company from prospective investors. The float and trading volume for securities of large-cap companies make it almost impossible to control the sell side of the market, even with strong-arm tactics. In addition, such companies tend to be more seasoned in terms of public reporting and, as a result, it is more difficult to create sudden, exciting hype about a company that would generate real buying volume from innocent investors. In addition, analysts are more likely to cover larger cap companies and regularly provide information on such companies to the marketplace.

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[26] Most of these actions did not allege the involvement of organized crime.

[27] In March 1997, the Commission brought an antifraud action in federal district court against Meyers Pollock and its president Michael Ploshnick for their role in a fraudulent debt offering. *SEC v. Namer,* Lit. Rel. No. 15307, 1997 SEC LEXIS 666 (March 26, 1997).

The most prevalent fraud in the microcap market is the "pump and dump" manipulation. The scheme centers on the spreading of false information—principally through either a "boiler room" or via the Internet—designed to artificially inflate a stock's price. Investors often receive information that is either exaggerated or completely fabricated. Those spreading the false information typically hold large amounts of stock and make substantial profits by selling after the price peaks. Upon selling their shares, the promoters cease their manipulative efforts, the stock price plummets, and innocent investors incur substantial losses.

Several rule and regulation amendments have been proposed and adopted by the SEC. An effective "pump and dump" scheme requires that those committing the fraud be able to quickly and cheaply obtain a supply of stock that can then be manipulated. The rulemakings to date have focused on creating obstacles for potential manipulators obtaining stock, while not unduly hampering legitimate capital raising efforts by small businesses. This section outlines these recent rulemakings which, we believe, have proven successful in abating microcap fraud.[28]

Regulation S—Regulation S provides a safe harbor from SEC registration for certain offshore offerings. Following the adoption of Regulation S, the SEC found that some issuers were using Regulation S as a means of indirectly distributing securities into the United States markets without registration. SEC investigations suggested that organized crime was using Regulation S offerings to obtain a cheap supply of stock to manipulate. In light of these problems, on February 10, 1998, the SEC adopted amendments to Regulation S. The amendments require, among other things, that: (i) equity securities placed offshore pursuant to Regulation S be classified as "restricted" securities, so that resales without registration are subject to holding periods and quantity limitations; and (ii) Regulation S securities cannot be resold into the United States for a period of one year, as opposed to the prior 40-day period. Based on our experience in recent investigations, our initial impression is that these amendments have been effective in reducing Regulation S abuses.

Rule 504—This rule, known as the "seed capital" exemption, allows non-reporting (generally start-up) companies to sell up to $1 million in securities without registration or restriction. To curb microcap abuses, in February 1999, the SEC modified Rule 504 to limit the circumstances where general solicitation is permitted and unrestricted "freely tradable" securities could be issued.[29]

Form S-8—Form S-8 is a short form available to register the offer and sale of securities to an issuer's employees as part of their compensation. These registration statements become effective automatically without SEC review. The staff has seen Form S-8 used improperly to raise capital, either by using the shares to pay broker-dealers or other consultants that assist in capital raising or by using employees or "consultants" as intermediaries to raise capital indirectly. The amendments adopted in February 1999 clarify that consultants and advisors can be treated as employees only if (i) they are natural persons, (ii) they provide bona fide services to the issuer, and (iii) their services are not related to capital-raising or the promotion of the issuer's securities.[30]

Rule 701—This rule allows private companies to sell securities to their employees without the need to file a registration statement. Amendments to the rule adopted in February 1999, among other things, harmonize the definition of consultant and advisor to that contained in Form S-8 and require specific disclosure from issuers that sell more than $5 million in 701 securities in a 12-month period.[31]

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[28] SEC staff is also working with the securities industry to develop other measures to reduce microcap fraud. For example, SEC staff is working with the NSCC/DTC, NYSE, NASD, and members of the SIA Clearing Committee on a data repository that will be used to store information that may be useful in detecting on-going fraudulent activities. The repository, located at the NASD, will receive daily information related to the clearing process from a number of different sources, including clearing firms, the NYSE, the NASD, and NSCC/DTC. The clearing firms will send information on their correspondents' cancelled and "as-of" trades, proprietary account equity, and unsecured customer debits. The NYSE and NASD will send information on Regulation T extensions, and NSCC/DTC will send exception reports when a member dominates the market in a given security or holds a substantial amount of the DTC inventory in a given security. A pilot program using the NASD's INSITE software system is currently underway.

[29] Specifically, the amendments require registration under state law requiring public filing and delivery of a disclosure document to investors before sale, or reliance on an exemption under state law permitting general solicitation and general advertising so long as sales are made only to experienced (i.e. "accredited") investors. 1933 Act Rel. No. 7644 (February 26, 1999).

[30] Another amendment also intended to address enforcement concerns provides that offerings registered on Form S-8 will no longer be presumed to have been filed on the proper form if the Commission does not object to the form before the effective date. 1933 Act Rel. No. 7646 (Feb. 26, 1999).

[31] 1933 Act Rel. No. 7645 (Feb. 26, 1999).

Rule 15c2-11—This rule is intended to deter the publication of stock quotations in the OTC Bulletin Board, the Pink Sheets and similar media that may be used in manipulative schemes. The current rule requires the first broker-dealer that publishes a quotation for a particular stock to review certain issuer information, including its most recent balance sheet, profit and loss, and retained earnings statements. Subsequent broker-dealers publishing quotations in that stock do not have to review this information; rather they are subject to a "piggyback" exception. To deter microcap manipulations, the SEC has proposed certain amendments to Rule 15c2-11 that would place greater information review requirements, and thus accountability, on broker-dealers publishing quotations and would provide greater investor access to information about those securities.

In addition, the Commission has recently approved two NASD rule proposals that are aimed at combating microcap fraud.

NASD OTC Bulletin Board Eligibility Rule—The Business Week Article reported, "[t]he Mob's activities seem confined almost exclusively to stocks traded in the over-the-counter 'Bulletin Board' and NASDAQ small-cap markets."[32] Bulletin board securities have traditionally been easier to manipulate than exchange traded securities because less public information was made available. NASD rule amendments, approved by the Commission on January 4, 1999, provide for enhanced disclosure of issuer information in this market. Specifically, the Commission approved the NASD's proposed amendments to NASD Rules 6530 and 6540. The amendment to Rule 6530 limits quotations on the OTC Bulletin Board to the securities of issuers that file reports with the Commission or banking or insurance regulators and are current in those reports. The amendment to Rule 6540 prohibits brokers from quoting a security on the Bulletin Board unless the issuer has made current filings.

NASD Taping Rule—On April 17, 1998, the Commission approved the NASD's proposed new rule requiring brokerage firms that employ a certain percentage of brokers who were employed by an expelled brokerage firm[33] within the last two years to tape record all of their brokers' telephone conversations with investors. The rule is designed to combat "boiler room" conduct. The threshold for triggering the taping requirement varies according to the size of the firm. In large firms, the rule applies if 20 percent of the firm's brokers were previously employed by disciplined firms, and in small firms the trigger is 10 percent.

Finally, a bill currently introduced in the Senate could also help combat microcap fraud. On June 9, 1999, Senator Susan Collins, Chairman of the Senate Permanent Subcommittee on Investigations, introduced the "Microcap Fraud Prevention Act of 1999" [the "1999 Bill"].[34] Among other things, the 1999 Bill would: (i) allow the SEC to bar fraudulent actors from participating in any securities offering, as opposed to only penny stock offerings; (ii) allow SEC enforcement actions to be predicated on state enforcement actions;[35] and (iii) allow the SEC to bar fraudulent actors from serving as officers or directors of any company, as opposed to only SEC reporting companies.

While the 1999 Bill enhances civil, and not criminal, remedies, it could still help deter organized crime involvement on Wall Street. Members of organized crime often need to recruit those in the securities industry, including brokers and promoters, to complete their schemes. The provisions of the 1999 Bill could make it harder to recruit these persons.

V. CONCLUSION

The Commission will continue to implement a vigilant program to safeguard the microcap securities market from involvement by organized crime or anyone else aiming to commit fraud. We will also continue to work closely with the Justice Department to make certain that every instance of organized crime on Wall Street is prosecuted criminally. As always, the Commission and its staff will be pleased to assist the Subcommittee as it goes forward.

Mr. OXLEY. Thank you, Mr. Walker.

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[32] The Business Week Article, *supra* note 14 at 94.

[33] The rule defined "expelled firm" as one that has been expelled from a self-regulatory organization in the securities industry or has had its registration revoked by the Commission for sales practice violations or telemarketing abuses.

[34] The 1999 Bill is co-sponsored by Senators Daniel Akaka, Max Cleland, and Judd Gregg.

[35] To date, the states have orchestrated two sweeps aimed at boiler rooms. In May 1997, 20 states accused 14 brokerage firms of violations including high pressure sales tactics. In July 1998, NASAA announced 100 enforcement actions against boiler rooms, including 64 actions involving brokers peddling microcap stocks.

The Chair would note that we have a vote on the floor, as we had predicted. So I will recess now so that we can then begin with Mr. Skolnik when we return, hopefully within 10 minutes or so. The subcommittee stands in recess.

[Brief recess.]

Mr. OXLEY. The subcommittee will reconvene.

We now recognize Mr. Bradley Skolnik, the Securities Commissioner from the State of Indiana. Welcome. It is good to have you here.

STATEMENT OF BRADLEY W. SKOLNIK

Mr. SKOLNIK. Thank you, Mr. Chairman.

Chairman Oxley and members of the subcommittee, I am Brad Skolnik, Indiana Securities Commissioner and President of the North American Securities Administrators Association. I thank you for the opportunity to appear today to present our views.

Why is the Mob making inroads on Wall Street? Because as bank robber Willie Sutton once said, that is where the money is. Wall Street is booming because in the past generation, we have become a Nation of investors. Half of American households are invested in the stock market. While that is bullish for the legitimate securities industry, it is also bullish for the crooks.

State securities regulators have been fighting a bull market in securities fraud, from microcap fraud to promissory notes, from foreign currency trading schemes to Internet scams.

Is there organized crime in the securities markets? Yes, we believe there is. How much securities fraud is Mob-related? No one can say precisely. From my experience in Indiana alone, I can tell you that organized crime on Wall Street is targeting investors on Main Street. In recent years my office has brought enforcement actions against firms such as Meyers Pollock, Stratton Oakmont, Toluca Pacific and PCM Securities, all microcap firms suspected of having ties in one form or another to organized crime figures.

Microcap fraud, some of it linked to organized crime, has cost Americans hundreds of millions of dollars, perhaps billions. Unlike The Godfather or The Sopranos, there is nothing entertaining or particularly endearing about the Mob on Wall Street.

While we can't tell you exactly how big the problem of the Mob on Wall Street is, we can tell you how to best fight it: by bringing more criminal prosecutions. The prospect of serious jail and prison time is the only way to deter calculating, cold-blooded recidivist criminals. Anything less could be viewed as just a cost of doing business.

The problem is securities cases are complex, costly and time-consuming, and some prosecutors shy away from them because of that. But from my perspective as a State securities regulator, white collar criminals who commit securities frauds deserve prison time just like thieves, muggers and murderers. Think about it. Someone steals your car, they go to prison. A con artist steals money your parents saved for retirement, and all too often they only get fined. That is simply not right.

Securities regulators have been successful in overseeing the activities of legitimate brokerage firms; however, we face serious challenges when outright criminal organizations enter the markets.

Traditional weapons to sanction firms and brokers who violate market regulations such as administrative fines and suspensions often have little effect on these criminals. They readily pay the crimes and consider them a cost of doing business. Regulators must provide deterrence to corrupt brokers and firms by bringing criminal cases and putting perpetrators in prison, period.

The closure of one firm and the barring of principals does not necessarily end the problem. Brokers at firms shut down by regulators have migrated to other firms or started new firms to continue their criminal activities. As you can see from this chart, a copy of which is attached to our testimony today, this agent-to-principals chart demonstrates how the microcap firm Stratton Oakmont was the beginning or the centerpiece, if you will, of a sophisticated network of corrupt brokers, promoters and agents. This interlocking web of companies and the migration of brokers from firm to firm is, in my view, evidence of enterprise corruption, if not outright racketeering.

As Mr. Walker noted today, by prosecuting the principal figures in the rogue firms, regulators and law enforcement agencies have made large strides toward removing criminal elements from the marketplace, but we need to keep the pressure on, as some of these criminal elements now migrate from the boiler rooms to the Internet.

Unfortunately many white collar criminals are creative and sophisticated. Therefore, if we hope to continue to protect our Nation of investors from fraud and abuse, our enforcement efforts must be enhanced and improved. Currently the SEC cannot take action based upon State actions against brokers and firms. The SEC should be empowered to rely on certain State actions as a basis for pursuing appropriate remedies under Federal law. This authority is similar to that used by the States at the current time. For example, in the case of Meyers Pollock, Indiana suspended the firm's license based on the initial action taken by the Secretary of State's office in Massachusetts.

Yes, Mr. Chairman, the Mob has made inroads in Wall Street. To fight it and other forms of organized crime, we need to bring many more criminal actions. If we do not, a cancer will grow on our securities markets, which could have very serious and perhaps very dire consequences. We need to put these crooks in prison. I pledge the support of the entire NASAA membership to work with you and to provide any additional information or assistance you may need. Thank you very much.

[The prepared statement of Bradley W. Skolnik follows:]

PREPARED STATEMENT OF BRADLEY W. SKOLNIK, INDIANA SECURITIES COMMISSIONER, PRESIDENT, NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

Chairman Oxley and Members of the Subcommittee: I am Brad Skolnik, Indiana Securities Commissioner and President of the North American Securities Administrators Association, Inc. (NASAA).[1] I commend you for holding this hearing and thank you for the opportunity to appear today to present our views.

[1] The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc., was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico and Puerto

Why is the Mob making inroads on Wall Street? Because, as bank robber Willie Sutton once said, that's where the money is. Wall Street is booming because in the past generation we've become a nation of investors. Half of American households are invested in the stock market. While that's bullish for the legitimate securities industry, it's also bullish for the crooks. Unfortunately, many of today's investors are relatively unsophisticated and susceptible to high-pressure sales tactics and bogus promises of guaranteed returns—the stock and trade of microcap stock firms and promoters.

State securities regulators have been fighting a bull market in securities fraud. From microcap fraud to promissory notes, from foreign currency trading schemes to Internet scams. Is there organized crime in the securities markets? Yes, we believe there is.

How much securities fraud is Mob related? No one can say precisely. From my experience in Indiana alone, I can tell you that organized crime on Wall Street is targeting investors on Main Street. For example, in recent years, the Securities Division of the Indiana Secretary of State's office has brought enforcement actions against Meyers Pollock Robbins, Stratton Oakmont, Inc., Toluca Pacific Securities Corp., and PCM Securities Limited—all these microcap firms are suspected of having ties, in one form or another to organized crime figures. The experience is similar in many other states. Microcap fraud, some of it linked to organized crime, has cost Americans hundreds of millions of dollars, perhaps billions. Unlike *The Godfather* or *The Sopranos*, there is nothing entertaining or endearing about the Mob on Wall Street.

While we can't tell you exactly how big the problem of the Mob on Wall Street is, we can tell you how to best fight it. **By bringing more criminal prosecutions.** The prospect of serious jail and prison time is the only way to deter these calculating, cold-blooded, recidivist criminals. Anything less could be viewed as just a cost of doing business.

The problem is, securities cases are complex, costly and time-consuming. The truth is some prosecutors shy away from them because the subject is complicated and difficult to understand. But from my perspective as a state securities regulator, white-collar criminals who commit securities fraud deserve prison time just like thieves, muggers and murderers.

Think about it: Someone steals your car—they go to prison. A con artist steals the money your parents saved for retirement and they get fined. That's not right.

We need to change our collective mind-set about white-collar crime. Make no mistake: Securities fraud is not a victimless crime. It destroys lives just as surely as street crime does.

State securities regulators bring more criminal cases for securities fraud than other regulators, obtaining an average of nearly 300 criminal convictions a year. But we need to get more convictions, **many** more.

I would like to acknowledge the cooperative efforts of the U.S. Attorney's Office and the Manhattan District Attorney's Office in working with the states securities agencies, the Securities and Exchange Commission (SEC) and the NASD Regulation (NASDR) and committing the resources to build cases against corrupt microcap stock firms. I believe the willingness to pursue these cases, which resulted in criminals going to jail, has sent a message and had an impact in reducing certain types of securities fraud.

Meyers Pollock Robbins fits the pattern state regulators have observed in the war against microcap stock fraud—commercial bribery, extortion, money laundering, market manipulation and suspected mobsters or their associates as clients.

In January of this year, Gordon Hall, the chief executive of HealthTech International, was convicted on charges he hired stock promoters—some with ties to organized crime—to bribe brokers to artificially inflate the price of his company's stock. Prosecutors said Hall entered into a bogus stock promotion consulting agreement with two individuals who allegedly had ties to the Bonnano crime family. That agreement led to Mob control of Meyers Pollock Robbins. At the trial, one of the defendants testified that he arranged for three brokers to be hired at Meyers Pollock Robbins to promote certain stocks, including HealthTech, which jumped 53% in a single day during the alleged scheme.

In April of this year, the New York District Attorney, in partnership with state regulators around the U.S., announced the indictment of 20 people on charges that they carried out a nationwide stock fraud scheme in connection with Meyers Pollock Robbins. In total, 42 individuals were under investigation but, by the time of the announcement, 22 individuals had already pled guilty to various criminal charges

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Rico. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

including enterprise corruption, money laundering, criminal possession of stolen property, criminal bribe receiving, grand larceny, falsifying business records and antitrust violations.

State regulators from Alabama, Colorado, Connecticut, Georgia, Indiana, Massachusetts, New Jersey, Pennsylvania, and Utah collected and analyzed brokerage records from Meyers Pollock Robbins to uncover and document fraudulent activities. State investigators also located and interviewed investor-victims of this criminal enterprise in states from New York to California. They heard heartbreaking testimony of stolen money, broken dreams and loss of faith—faith in our financial markets and faith in our regulatory and legal systems.

For example, a woman who lived in a nursing home lost more than $100,000 when brokers at Meyers Pollock Robbins made unauthorized trades in her account. She lost 95% of her assets and her 50-year-old son-in-law had to take a second job just so that she could stay in the nursing home.

The District Attorney brought some of these victims to New York, where they testified before a grand jury that returned indictments against those involved in the Meyers Pollock Robbins criminal enterprise. Among other things, the indictment alleged that the president of Meyers Pollock Robbins assisted stock promoters to sell overvalued and worthless stock through the firm and assisted would-be principals of securities firms to own and operate branches of Meyers Pollock Robbins, even if they were not licensed. He collected "consulting fees" from the promoters and collected a percentage of the gross from each of the branch offices. The indictment alleged that other criminals provided stock to Meyers Pollock Robbins as undisclosed promoters of the stocks. Each paid bribes or other undisclosed compensation to brokers to sell their securities.

At these firms and others, state securities investigators have seen "pump and dump" schemes similar to those reported in press accounts describing Mob involvement on Wall Street. Here's how it works: The mobsters pay, say, 50 cents a share to buy a stake in a company that's going public. Then they go to a brokerage firm they control and have its brokers cold-call unsuspecting clients and hype the stock so that it sells for, say, $5 a share. Once the shares are pumped and dumped on the market, the hype stops and the mobsters sell their shares for a big profit. As a result of the sudden glut of shares on the market, the stock price plummets, investors are left with often nearly worthless pieces of paper, the brokers get their fat commissions and the Mob makes a killing. Why would a company go to the Mob for help? "Because the Mob guys have the cash and the wherewithal to make it happen."[2]

Time and time again state securities regulators, in their investigations of microcap stock fraud cases, have turned up people who are afraid to testify, or who if they do agree to go on the record wear hoods at hearings to conceal their faces out of fear of retaliation.

Historically, securities regulators have been successful in overseeing the activities of the legitimate brokerage firms. However, they faced serious challenges when outright criminal organizations entered the markets in recent years. Traditional weapons to sanction firms and brokers who violate market regulations—such as administrative fines and suspensions—have little effect on these criminals. They readily pay fines and consider them a cost of doing business. Regulators must provide deterrents to corrupt brokers and firms by bringing criminal cases and putting the perpetrators in prison. Period.

It's important to note that the closure of one firm and the barring of several principals who have already made their money does not end the problem. Brokers at firms shut down by regulators have migrated to other firms, or started new firms, to continue their criminal activities.

The poster child for microcap stock fraud was Stratton Oakmont, which had its headquarters in New York. An indicted mobster, one Philip Barretti Sr., was a stockholder in a Stratton backed Initial Public Offering (IPO). Other microcap firms associated with Stratton included Biltmore Securities, Duke & Company, Monroe Parker, First Jersey Securities and Hibbard Brown. As you can see from the attached "Agent to Principal" chart, this was a sophisticated network of corrupt brokers, promoters and agents. This interlocking web of companies and the migration of brokers from firm to firm is, in my view, evidence of enterprise corruption, if not racketeering.

In response to the criminal threat to the marketplace, NASAA member states have developed a task force concept to share personnel, information and resources. In addition, NASAA has developed a close working relationship with experienced criminal prosecutors in states where corrupt brokerage firms are located. NASAA

[2] "Wise Guys on Wall Street" by John Connolly; George Magazine; December, 1998

member states provide the securities market expertise to detect and document crime in the marketplace. The prosecutors then present the cases for trial. However, even this concept does not provide the manpower needed to adequately address the problem. Therefore, NASAA has been forced to adopt a strategy of concentrating primarily on those rogue brokers and principals who are capable of establishing new firms, or migrating to existing firms and continuing their criminal activities.

For example, as a result of the Duke & Company investigation, 24 owners, principals, supervisors and brokers were indicted on criminal charges. It is believed that perhaps dozens more brokers, sales assistants and cold callers could have been charged, but the manpower was not available to administer such a heavy case load.

NASAA member states have tracked an "Agent to Principal" progression in and among rogue brokerage firms. This tracking has demonstrated that some talented criminals who begin as brokers, go on to manage their own firms. By prosecuting the principal figures in the rogue firms, regulators and law enforcement agencies have made large strides toward removing criminal elements from the marketplace. We need to keep the pressure on, as some of these criminal elements migrate out of the boiler room and onto the Internet, arguably a more efficient medium to commit fraud.

Unfortunately, many white-collar criminals are creative and sophisticated. Therefore if we hope to continue to protect our nation of investors from fraud and abuse our enforcement efforts must be enhanced and improved. Currently, the Securities and Exchange Commission cannot take action based upon state actions against issuers, brokers, dealers, investment advisers and affiliated persons. This creates duplication of enforcement effort and expenditure of limited resources. Our system of regulation works best when each regulator complements the other, leveraging resources, strengths and expertise.

We recommend that where a state has issued an administrative enforcement adjudication, obtained a conviction or where a state court has issued an order or injunction, the SEC should be empowered to rely on that state action as a basis for pursuing appropriate remedies under federal law. The SEC should not be required to expend the time and resources to replicate state investigations in order to obtain relief or sanctions authorized by federal law.

This authority is similar to that regularly utilized by the states. For example, in the case of Meyers Pollock Robbins, Indiana suspended the firm's license based on the initial action taken by the Secretary of State's office in Massachusetts. A number of states, including Indiana, had pending investigations based on the firm's problems within their borders, but relied on the Massachusetts case for their actions. This allowed us to move faster, thereby protecting investors within our jurisdictions.

Mr. Chairman, I applaud you for holding these hearings in an effort to shed light on the criminal abuses in the securities markets. The problems in this area are serious and systemic, but can be successfully addressed if securities regulators and policy makers work together on solutions.

Yes, the Mob is making inroads on Wall Street. To fight it and other forms of organized crime, we need to bring many more criminal actions. If we don't, a cancer will grow on our securities markets, which could have very serious and perhaps very dire consequences. We need to put these crooks in prison.

I pledge the support of the entire NASAA membership to work with you and provide any additional information or assistance you may need. Thank you.

Agent to Principal Progression

First Jersey Securities Inc.**
1974-1995

Robert Brennan-Owner
Michael Hart
William P. Hoth
Roger Barnett
James Villa
David K. Nelson
Edward McCune

Investors Center**
1984-1989

Jordan Belfort
Daniel Porush
Kenneth Greene
Brian Anguili
Marc Ian Burton
Alan Lipsky
Elliot Loewenstern
Stephen Polumbo
Richard Puccio
Joseph Dortona
Leslie Lunsford

Greg Thaler
Jason Wang
Brian Anguili
Victor Wang
Greg De Luca
Charles Bennett
Joseph Teseo

Stratton Oakmont Inc. **
1987-1997

Jordan Belfort-Owner
Daniel Porush-President
Kenneth Greene-Owner

Elliott Loewenstern
Alan Lipsky
Bryan Herman
Michael Valenoti
Joseph Dortona

Broadchild Securities Corp**
alias D.H. Blair
1978-1986

Joseph Davis

D.H. Blair & Co. Inc.
1995-Present

Joseph Davis Pres.
Jordan Belfort
Robert Flandra
Helmut Meister

Mark Hanna
Jeffrey Gray
Stephen Polumbo
Shane Ferras
Richard Puccio
George M. Greco
Michael Weiner
Thomas Marinovich

Hibbard Brown **
1990-1996

Michael Hart
William Hoth
Leslie Lunsford
David K. Nelson

H. J. Meyers & Co. Inc.
1995-Present

James Villa-CEO
Greg Thaler
Jason Wang
Brian Anguili
Robert Flandra
Helmut Meister

Duke & Co. Inc.
1979-Present

Victor Wang
Jason Wang
Greg De Luca
Charles Bennett
Joseph Teseo
Anthony Vitola
GregThaler

White Rock Partners & Co. Inc.
1983-1997

Gennesday Klotsman
Walter Durchhalter-V.P.
Joseph Dortona

Mason Hill & Co, Inc
1995-Present

Walter Durchhalter-Sec.

Hyde Park Advisors Ltd.
1997-Present

Gennesday Klotsman-Pres.

Biltmore Securities
1989-Present

Elliott Loewenstern-Pres.
Alan Lipsky-Br.Mgr.
Bryan Herman
Richard Levitov
Marc Ian Burton

Windsor Reynolds Securities Inc.**
1973-1996

Marc Ian Burton-Pres.

Monroe Parker Securities Inc.
1992-Present

Alan Lipsky-Pres.
Bryan Herman-V.P.
Richard Levitov
Michael Valenoti

Harriman Group
1983-Present

Mark Hanna-V.P.
Jeffrey Gray-Dir. Ops.
Stephen Polumbo-V.P.
Shane Ferras-Gen. Pr.
Richard Puccio
George M. Greco

Investors Associates, Inc
1969-Present

Brian Anguili
Thomas Marinovich
Brian C. Burke
Anthony Vitola

Foster Jefferies Securities Corp.
1992-Present

George Greco-Vice President
Michael Weiner-Vice President
Thomas Marinovich-Supervisor
Brian Burke-Supervisor

VTR Capital
1988-Present

Brian Anguili
William Hoth
David K. Nelson
Edward McCune

**** Closed by a regulatory agency**

All individuals are agents unless otherwise specified.

Mr. OXLEY. Thank you, Mr. Skolnik.

Our final witness today is Mr. Barry Goldsmith, Executive Vice President for NASD Regulations.

Mr. Goldsmith.

STATEMENT OF BARRY R. GOLDSMITH

Mr. GOLDSMITH. Thank you, Chairman Oxley. And I wish to thank the entire subcommittee for the opportunity to testify here today.

My name is Barry Goldsmith. I am the Executive Vice President of Enforcement for NASD Regulation, Inc.

America's securities markets are essential to the capital formation process and economic well-being of our Nation. Ours are the strongest, the safest and the best regulated markets in the world. Only a tiny fraction of the 5,600 securities firms and the more than 650,000 registered industry professionals are involved in any form of criminal activity, and even a smaller number are ever involved with organized crime. Nevertheless, any attempt by organized criminal elements to influence the securities markets is unacceptable.

NASDR jurisdiction extends only to member securities firms and their associated persons. It does not include criminal prosecution authority, nor do we have the same investigative powers available to the FBI and other law enforcement agencies. While we can and we do throw the worst offenders out of the industry, last year nearly 500 of them, we can't throw them in jail, but we certainly can and do help the criminal prosecutors do just that. NASDR, along with the SEC, has assisted law enforcement agencies in every recent major public prosecution involving organized crime in the securities markets. It is the criminal prosecutors with ours and others' assistance who have the powers and broad jurisdictional reach to effectively prosecute these cases and impose the necessary criminal sanctions.

That being said, we recognize the critical role NASDR must play in protecting our markets from criminal activity and organized crime. We do this in three main ways. First, we provide hands-on assistance to criminal prosecutors through our enforcement, market and member regulation departments, and in particular through our criminal prosecution assistance group known as CPAG; second, by enacting tough new rule proposals, in particular the NASDR taping rule which I will discuss in a moment; and third, by enhanced efforts to train Federal, State and local prosecutors in the technical workings of our markets.

NASDR has a long history of supporting criminal securities prosecutions spanning the past 25 years. Our market regulation department here in Rockville conducts ongoing surveillance of all NASDAQ and over-the-counter market activity. This is an enormous task that includes monitoring over 10,000 securities on a daily basis. That department referred over 230 matters to the SEC and criminal law enforcement agencies last year.

Our enforcement department's criminal prosecution assistance group, known as CPAG, works directly and extensively with criminal prosecutors on time-intensive securities investigations and prosecutions. CPAG provides law enforcement agencies with what

we can bring to the table, and that is expertise in the securities markets.

CPAG has been involved in about 200 separate criminal matters since its inception 2½ years ago. Among other things, it provides detailed analysis of trading records and related documentation, offers advice and training to prosecutors and agents, provides summary and expert testimony, creates demonstrative exhibits, and assists in the trying of cases by becoming special prosecutors or special district attorneys.

Several of the most important criminal cases we have worked on are outlined in my written testimony. I would like to submit for the record a set of press releases from those cases which describes our joint efforts.

Mr. OXLEY. Without objection. Thank you.

[The information referred to follows:]

United States Attorney
Southern District of New York

FOR IMMEDIATE RELEASE
JANUARY 21, 1999

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PRESS RELEASE

MARY JO WHITE, the United States Attorney for the Southern District of New York, announced today that seven defendants, including high-level members and associates of Genovese Organized Crime Family and the Bonanno Organized Crime Family and several stock brokers, pled guilty today to charges of securities fraud and extortion in connection with their participation in a scheme to unlawfully raise the market price of certain securities. Three other defendants pled guilty earlier this week.

The 10 defendants who pled guilty before United States

District Judge Denny Chin are among 19 defendants who were originally indicted in November 1997 and charged with various offenses, including racketeering, securities fraud, wire fraud, extortion and bank fraud.

According to the indictment, the defendants entered into an agreement to manipulate the market price of the securities of HealthTech International, Inc. ("HealthTech"), an Arizona-based corporation. Among the means the defendants used to carry out their scheme was the payment of illegal secret compensation to brokers and principals at two branch offices of Meyers Pollock & Robbins, Inc., a brokerage firm, with the understanding that, in breach of the brokers' duties to their customers, the brokers would not disclose these payments to the customers.

ROSARIO GANGI, a/k/a "Rossi," a/k/a "Ross," a Capo in the Genovese Organized Crime Family, pled guilty today to the conspiracy to manipulate the price of HealthTech International, Inc. In addition, GANGI pled guilty to participating in four conspiracies to commit extortion that grew out of and were related to the scheme to manipulate the price of certain securities.

GANGI faces a maximum sentence of five years in prison on the securities fraud conspiracy, and a maximum of 20 years in prison on each of the conspiracies to commit extortion. Under the Sentencing Guidelines, GANGI is facing a range of 87-108 months in prison which may run concurrently with a term of 70 months' imprisonment that GANGI is serving for his conviction on unrelated racketeering charges.

FRANK LINO, a/k/a "Curly," allegedly a Capo in the Bonanno Organized Crime Family, pled guilty today to participating in the conspiracy to manipulate the price of HealthTech securities and to one related extortion conspiracy. LINO faces a maximum of five years in prison on the securities fraud conspiracy, and 20 years on the conspiracy to commit

extortion. Under the Sentencing Guidelines, LINO is facing a range of 57-71 months in prison.

JOHN CERASANI, a/k/a "Boobie," allegedly a soldier in the Bonanno Organized Crime Family, pled guilty earlier today to participating in the conspiracy to extort the owner and employees of the New Hyde Park branch of the brokerage firm of Meyers Pollock & Robbins. CERASANI faces a maximum of 20 years in prison. Under the Sentencing Guidelines, CERASANI is facing a sentencing range of 41-51 months' imprisonment.

EUGENE LOMBARDO, a/k/a "Gene," allegedly an associate of the Bonanno Organized Crime Family, pled guilty to the same charges as GANGI and also is facing the same maximum sentences, with a Sentencing Guidelines range of 87-108 months' imprisonment. In addition, LOMBARDO agreed not to challenge the forfeiture of approximately $400,000 that was seized from one of his bank accounts in connection with the bank fraud charges in the indictment.

ROBERT SCHWICKRATH, a/k/a "Bobby," pled guilty to participating in two extortion conspiracies related to the defendants' efforts to control another brokerage firm, TAJ Global Equities, Inc. In addition, SCHWICKRATH pled guilty to participating in an unrelated conspiracy to manipulate the price of securities. SCHWICKRATH faces a maximum of 20 years in prison on each extortion conspiracy and five years on the securities charge with a Sentencing Guidelines range of 41-51 months' imprisonment.

ARNOLD SCHNEIDER and LAWRENCE SCHNEIDER, brokers who were in charge of the Meyers Pollock & Robbins offices where the securities were sold, pled guilty to participating in a conspiracy to commit securities fraud and face a maximum of five years in prison. Under the Sentencing Guidelines, they face a range of 27-33 months' imprisonment.

PHIL DEFONTE, SAL TADDEO and THOMAS SCARPACI also pled guilty to conspiracy to commit securities fraud and each faces a

maximum of five years in prison. DEFONTE faces a Sentencing Guidelines range of 21-27 months' imprisonment, TADDEO 18-24 months' imprisonment, and SCARPACI 24-30 months' imprisonment.

Each defendant also faces a maximum fine of $250,000 or twice the gross gain or loss resulting from the crime on each count.

The 10 defendants who pled guilty this week are scheduled to be sentenced by Judge CHIN in May 1999.

Trial of the remaining defendants who have not yet pled guilty -- including GORDON HALL, an officer of HealthTech -- is scheduled for February 16, 1999.

Ms. WHITE praised the efforts of all of the law enforcement agencies involved, and particularly commended the efforts of the FBI and NYPD task force that is principally responsible for investigating the criminal activities of the Genovese Family. Ms. WHITE also thanked the Securities and Exchange Commission ("SEC") and the Criminal Prosecution Assistance Group of the National Association of Securities Dealers ("NASD") for their assistance.

Assistant United States Attorneys CELESTE KOELEVELD, DOUGLAS LANKLER and JANE LEVINE and Special Assistant United States Attorney JASON SABOT are in charge of the prosecution.

99-13 ###

FOR IMMEDIATE RELEASE
MAY 11, 1999

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PRESS RELEASE

MARY JO WHITE, the United States Attorney for the Southern District of New York, announced today that GORDON HALL and MICHAEL MOTSYKULASHVILI were convicted on 12 counts of racketeering, securities fraud and wire fraud violations after a seven-week trial before United States District Judge DENNY CHIN. The two defendants were among 20 defendants, including high-level members and associates of the Genovese Organized Crime Family and the Bonanno Organized Crime Family, originally charged in November 1997 with participating in a scheme to unlawfully manipulate the market price of certain securities. Earlier this year, 14 of the defendants pled guilty to securities fraud and extortion charges.

The proof presented at trial demonstrated that, in late 1996, HALL, the Chairman of HealthTech International, Inc., a small publicly-held company in the physical fitness industry, hired stock promoters, including EUGENE LOMBARDO, an associate of

the Bonanno Organized Crime Family, who promised to artificially increase the market price of HealthTech securities by paying extraordinary compensation to stock brokers, with the understanding that, in breach of their obligations to their customers, the stock brokers would not disclose the payments to their customers. Among the brokers paid off was MOTSYKULASHVILI, who also helped supervise and pay off a group of brokers at the New Hyde Park, Long Island, New York, branch of Meyers Pollock & Robbins, Inc., a now-defunct brokerage firm, who in turn retailed HealthTech securities to their unsuspecting customers. As a result of the scheme, the price and trading volume of HealthTech securities rose dramatically in January 1997.

The proof further established that MOTSYKULASHVILI and his partners, ARNOLD SCHNEIDER and LAWRENCE SCHNEIDER, were closely connected with LOMBARDO and ERNEST MONTEVECCHI, a member of the Genovese Organized Crime Family. In late January and February 1997, the brokers controlled by MOTSYKULASHVILI and his partners at the Meyers Pollock & Robbins branch had a number of disputes with JONATHAN LYONS, the owner of the branch, who aligned himself with a rival faction of the Bonanno Family. To resolve these disputes, MOTSYKULASHVILI and his partners relied on their ties to MONTEVECCHI and LOMBARDO, who attended a "sit-down" on MOTSYKULASHVILI's behalf. As a result of the "sit-down", MOTSYKULASHVILI and his partners retained control of the Meyers Pollock branch.

In April 1997, the defendants continued their scheme to

raise the price of HealthTech securities at another Meyers Pollock branch office located at 100 Wall Street in Manhattan, according to the evidence. In furtherance of the scheme, HALL caused HealthTech to issue free warrants to the brokerage firm, which were then sold so that the proceeds could be used to pay extraordinary commissions to brokers at Meyers Pollock. Again, the price and volume of HealthTech securities rose dramatically, this time with a focus on HealthTech warrants. Hundreds of investors later lost substantial portions of their investments when the defendants stopped supporting the market with the secret payments to the brokers, causing the price of the warrants to plummet.

The proof also demonstrated that the promoters and the brokers, including MOTSYKULASHVILI, considered other fraudulent schemes involving other securities besides HealthTech, some of which involved companies connected to other members and associates of the Bonanno and Genovese Organized Crime Families. In addition, in the fall of 1997, the evidence showed, HALL considered another business deal with the stock promoters.

Both defendants were convicted of conspiracy to violate RICO, a substantive RICO charge, three counts of securities fraud, and six counts of wire fraud. The RICO charges each carry a statutory maximum of 20 years' imprisonment; the securities fraud charges a maximum of 10 years' imprisonment; and the wire fraud charges a maximum of five years' imprisonment. In addition, the RICO and wire fraud charges carry a maximum fine of

$250,000 or twice the gross gain or loss resulting from the offense. The securities fraud charges carry a maximum fine of $1 million or twice the gross gain or loss. Judge CHIN scheduled sentencing for September 8, 1999.

The 14 defendants who have pled guilty entered their guilty pleas in January, February and March of this year. These defendants are as follows:

-- ROSARIO GANGI, a/k/a "Rossi," a/k/a "Ross," a Capo in the Genovese Organized Crime Family, pled guilty to conspiring to manipulate the price of HealthTech International, Inc. and to participating in four conspiracies to commit extortion that grew out of and were related to the scheme to manipulate the price of certain securities. GANGI faces a maximum sentence of five years in prison on the securities fraud conspiracy, and a maximum of 20 years in prison on each of the conspiracies to commit extortion. Under the Sentencing Guidelines, GANGI is facing a range of 87-108 months in prison which may run concurrently with a term of 70 months' imprisonment that GANGI is serving for his conviction on unrelated racketeering charges.

-- FRANK LINO, a/k/a "Curly," allegedly a Capo in the Bonanno Organized Crime Family, pled guilty to participating in the conspiracy to manipulate the price of HealthTech securities and to one related extortion conspiracy. LINO faces a maximum of five years in prison on the securities fraud conspiracy, and 20 years on the conspiracy to commit extortion. Under the Sentencing Guidelines, LINO is facing a range of 57-71 months in

prison.

-- ERNEST MONTEVECCHI, a/k/a "Butch," allegedly a soldier in the Genovese Organized Crime Family, pled guilty to participating in the conspiracy to manipulate the price of HealthTech securities and to two related extortion conspiracies. MONTEVECCHI faces a maximum of five years in prison on the securities fraud conspiracy, and 20 years on each conspiracy to commit extortion. Under the Sentencing Guidelines, MONTEVECCHI is facing a range of 63-78 months in prison.

-- JOHN CERASANI, a/k/a "Boobie," allegedly a soldier in the Bonanno Organized Crime Family, pled guilty to participating in a conspiracy to extort the owner and employees of the New Hyde Park branch of the brokerage firm of Meyers Pollock & Robbins. CERASANI faces a maximum of 20 years in prison. Under the Sentencing Guidelines, CERASANI is facing a sentencing range of 41-51 months' imprisonment.

-- EUGENE LOMBARDO, a/k/a "Gene," allegedly an associate of the Bonanno Organized Crime Family, pled guilty to the same charges as GANGI and also is facing the same maximum sentences, with a Sentencing Guidelines range of 87-108 months' imprisonment. In addition, LOMBARDO agreed not to challenge the forfeiture of approximately $400,000 that was seized from one of his bank accounts in connection with the bank fraud charges in the indictment.

-- IRWIN SCHNEIDER, one of the stock promoters, pled guilty pursuant to a cooperation agreement with the Government to

conspiracy to violate the RICO statute. He testified for the Government at trial. He faces a maximum sentence of 20 years' imprisonment under the statute.

-- ROBERT SCHWICKRATH, a/k/a "Bobby," pled guilty to participating in two extortion conspiracies related to the defendants' efforts to control another brokerage firm, TAJ Global Equities, Inc. In addition, SCHWICKRATH pled guilty to participating in an unrelated conspiracy to manipulate the price of securities. SCHWICKRATH faces a maximum of 20 years in prison on each extortion conspiracy and five years on the securities charge with a Sentencing Guidelines range of 41-51 months' imprisonment.

-- ARNOLD SCHNEIDER and LAWRENCE SCHNEIDER, brokers who, along with MOTSYKULASHVILI, were in charge of the Meyers Pollock & Robbins offices where the securities were sold, pled guilty to participating in a conspiracy to commit securities fraud and face a maximum of five years in prison. Under the Sentencing Guidelines, they face a range of 27-33 months' imprisonment.

-- PHIL DEFONTE, SAL TADDEO and THOMAS SCARPACI also pled guilty to conspiracy to commit securities fraud and each faces a maximum of five years in prison. DEFONTE faces a Sentencing Guidelines range of 21-27 months' imprisonment, TADDEO 18-24 months' imprisonment, and SCARPACI 24-30 months' imprisonment.

-- JONATHAN LYONS, a broker who ran the New Hyde Park

office of Meyers Pollock & Robbins in late 1996 and early 1997, pled guilty to conspiracy to commit securities fraud and faces a maximum sentence of 5 years' imprisonment under the statute.

-- JOSEPH KIRKHAM, formerly the Vice President of HealthTech in charge of its medical operations, pled guilty to misprision of a felony. KIRKHAM faces a Sentencing Guidelines range of 0-6 months' imprisonment.

Each defendant who pled guilty also faces a maximum fine of $250,000 or twice the gross gain or loss resulting from the crime on each count.

The defendants who pled guilty are scheduled to be sentenced in May and June 1999.

Ms. WHITE praised the efforts of all of the law enforcement agencies involved, and particularly commended the efforts of the FBI and NYPD task force that is principally responsible for investigating the criminal activities of the Genovese Family. Ms. WHITE also thanked the Criminal Prosecution Assistance Group of NASD Regulation, Inc., and the United States Securities and Exchange Commission for their assistance.

Assistant United States Attorneys CELESTE KOELEVELD, DOUGLAS LANKLER and JANE LEVINE and Special Assistant United States Attorney JASON SABOT are in charge of the prosecution.

99-81 ###

United States Attorney
Southern District of New York

FOR IMMEDIATE RELEASE
NOVEMBER 25, 1997

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PRESS RELEASE

MARY JO WHITE, the United States Attorney for the Southern District of New York, JAMES K. KALLSTROM, Assistant Director in Charge of the FBI's New York Office, WILLIAM R. McLUCAS, Director of Enforcement of the Securities and Exchange Commission, and New York City Police Commissioner HOWARD SAFIR announced today that two high-level members of organized crime families and 17 other defendants, including members and associates of the Genovese Organized Crime Family, the Bonanno Organized Crime Family, several stock brokers, and two officers of an Arizona-based corporation, have been indicted by a Manhattan federal grand jury on racketeering and other charges, including securities fraud, wire fraud, extortion and bank fraud.

Of the 19 defendants charged in the 25-count Indictment, 18 have been arrested and one is expected to surrender tomorrow. In addition to the arrests, search warrants were executed at the offices of Meyers Pollock Robins Inc. at 100 Wall Street in Manhattan, as well as the homes of EUGENE LOMBARDO in Brooklyn, New York and CLAUDIO IODICE and IRWIN SCHNEIDER in Boca Raton, Florida.

The charges grew out of a year-long investigation by the United States Attorney's Office, the FBI, the SEC and the NYPD with the assistance of the National Association of Securities Dealers-Regulation.

Ms. WHITE stated: "Today's racketeering and forfeiture charges, which are the result of a coordinated investigation by the U.S. Attorney's Office for the Southern District of New York, the FBI, the SEC, the NYPD, and the NASD, is law enforcement's response to efforts by members of Organized Crime and their associates to extend their unlawful activities to the federal securities markets. These attempts are relatively isolated, and do not threaten the overall stability of our markets. Nonetheless, the charges in the Indictment, which include allegations that members of Organized Crime joined forces with unscrupulous stock promoters and officers of a publicly-traded company, infiltrated a registered broker-dealer, and used threats, extortion, and violence as part of a scheme to manipulate stock, are extremely troubling. We will use every

weapon in the prosecutorial arsenal to ensure that these activities are prosecuted to the full extent of the law.

Among the defendants indicted were ROSARIO GANGI, a/k/a "Rossi," a/k/a "Ross," and ERNEST MONTEVECCHI, a/k/a "Butch," a/k/a "Green Eyes," who are alleged to be a Capo and soldier, respectively, in the Genovese Organized Crime Family, and FRANK LINO, a/k/a "Curly," and JOHN CERASANI, a/k/a "Boobie," who are alleged to be a Capo and soldier, respectively, in the Bonanno Organized Crime Family. Other defendants also indicted were EUGENE LOMBARDO, a/k/a " Gene," and CLAUDIO IODICE, purportedly stock consultants, and IRWIN SCHNEIDER, a disbarred securities lawyer. GORDON HALL, the Chairman and Chief Executive Officer of HealthTech International Inc., a corporation based in Mesa, Arizona, with common stock and warrants traded publicly on the National Association of Securities Dealers Automated Quotation system small-cap market, and JOE KIRKHAM, formerly HealthTech's Senior Vice President and President of its Medical Operations Division, also were indicted. Brokers affiliated with branch offices of Meyers Pollock Robbins Inc. in Manhattan and Long Island, and associates of both the Genovese and Bonanno families, were also indicted.

The defendants are scheduled to be presented before United States Magistrate Judge DOUGLAS F. EATON, in Manhattan federal court today.

The Indictment charges that in December 1996, EUGENE LOMBARDO, IRWIN SCHNEIDER, and CLAUDIO IODICE entered into an

unlawful agreement with GORDON HALL, whereby LOMBARDO, IRWIN SCHNEIDER, IODICE and others would be paid with HealthTech securities from HALL in exchange for unlawfully raising the market price of HealthTech securities.

The defendants joined with JONATHAN LYONS, of Meyers Pollock's New Hyde Park branch office, in efforts to raise the market price for HealthTech common stock and warrants by causing securities brokers under their control to sell securities of HealthTech to their clients at times and in amounts designed unlawfully to raise the price of HealthTech common stock. LYONS is also facing other pending securities charges in both the Southern and Eastern Districts of New York.

In furtherance of the agreement to raise the market price for HealthTech securities, according to the charges, certain registered representatives and others at Meyers Pollock's New Hyde Park Office unlawfully induced investors to purchase HealthTech securities by, among other things, engaging in a series of "boiler-room" sales practices, including making material misrepresentations to their customers about the nature and quality of HealthTech and its securities and about the material terms of HealthTech warrants. In addition, these Meyers Pollock registered representatives and others received illegal secret compensation from LOMBARDO, IODICE, IRWIN SCHNEIDER, ARNOLD SCHNEIDER, LAWRENCE SCHNEIDER and MICHAEL MOTSYKULASHVILI for sales of HealthTech securities to their customers with the knowledge and understanding that, in breach of those registered

representatives' duties to those customers, the registered representatives would not disclose these payments to the customers, the Indictment charges.

The Indictment also charges that in January and February 1997, LOMBARDO, IODICE and IRWIN SCHNEIDER attempted to assert increased control over the activities at the Meyers Pollock New Hyde Park Office. LOMBARDO, IODICE and IRWIN SCHNEIDER, with the backing of GANGI, LINO and MONTEVECCHI, enlisted JOHN CERASANI and DANNY GUMA to extort and threaten JONATHAN LYONS and others at Meyers Pollock in order to maintain their control over the brokerage.

It is also charged that the defendants, under the direction of GANGI, LINO and MONTEVECCHI, later controlled another Meyers Pollock branch located at 100 Wall Street in Manhattan, where they continued to raise the market price of the securities of HealthTech for several months.

The effect of the defendants' actions on HealthTech's securities is alleged to have been significant. The Indictment charges that on or about January 2, 1997, the day the defendants started artificially supporting HealthTech's trading price and volume, HealthTech's trading volume increased over 250% as compared to the prior day's trading. The closing price of HealthTech common stock also increased 53% from the prior day's closing price. For the month of January 1997, 2,314,156 shares of HealthTech common stock were traded, as compared to only 642,845 shares for the month of December 1996. Trading in the

common stock at similar levels was sustained for several months.

The defendant's fraudulent actions caused the price and volume of HealthTech warrants to increase dramatically during February through June 1997, it was charged and during May and June 1997, Meyers Pollock brokers were responsible for over 80% of all retail customer purchases in HealthTech warrants. On November 17, 1997, The SEC suspended trading in HealthTech stock and warrants due to questions concerning the accuracy and adequacy of publicly disseminated information about the company.

In addition to the extortion of LYONS, the Indictment charges two additional extortions relating to the defendants' efforts to control another brokerage, TAJ Global Equities, Inc., located in Tampa Florida. It is also alleged that as disputes between HALL and certain of the defendants arose, HALL and other HealthTech principals were later extorted to maintain their alliance with the other defendants.

The indictment alleges that EUGENE LOMBARDO, CLAUDIO IODICE and IRWIN SCHNEIDER each received, free of charge, large amounts of HealthTech securities issued at GORDON HALL's direction for their participation in the scheme. LOMBARDO, IODICE and IRWIN SCHNEIDER sold these securities during the course of the scheme for a profit of over $1.36 million.

If convicted of the racketeering violations, GANGI, LINO, MONTEVECCHI, CERASANI, LOMBARDO, IODICE, SCHNEIDER, ROBERT SCHWICKRATH, and HALL, each face a maximum sentence of 40 years in prison.

The indictment also seeks forfeiture to the United States of numerous assets of the defendants including approximately $1.8 million, representing the proceeds of the charged acts of racketeering, property, and numerous bank accounts belonging to the defendants.

Ms. WHITE praised the efforts of all of the law enforcement agencies involved, and particularly commended the efforts of the FBI and NYPD task force that is principally responsible for investigating the criminal activities of the Genovese Family.

Assistant United States Attorneys JAY HOLTMEIER, DOUGLAS LANKLER and BRUCE OHR, and Special Assistant United States Attorney JASON SABOT are in charge of the prosecution.

The charges contained in the indictment are merely accusations, and the defendants are presumed innocent unless and until proven guilty.

The defendants face the following maximum sentence if convicted of all charges:

Defendant	Charge	Number of Counts	Maximum Penalty Per Count
ROSARIO GANGI	Racketeering	2	20 years
	Conspiracy To Commit Securities Fraud	1	5 years
	Securities Fraud Under Section 10(b)	3	10 years
	Securities	2	5 years

	Fraud Under Section 17(a)		
	Wire Fraud	4	5 years
	Extortion	8	20 years
FRANK LINO	Racketeering	2	20 years
	Conspiracy To Commit Securities Fraud	1	5 years
	Securities Fraud Under Section 10(b)	3	10 years
	Securities Fraud Under Section 17(a)	2	5 years
	Wire Fraud	4	5 years
	Extortion	8	20 years
ERNEST MONTEVECCHI	Racketeering	2	20 years
	Conspiracy To Commit Securities Fraud	1	5 years
	Securities Fraud Under Section 10(b)	3	10 years
	Securities Fraud Under Section 17(a)	2	5 years
	Wire Fraud	4	5 years
	Extortion	8	20 years
JOHN CERASANI	Racketeering	2	20 years
	Conspiracy To Commit	1	5 years

	Securities Fraud		
	Securities Fraud Under Section 10(b)	3	10 years
	Securities Fraud Under Section 17(a)	2	5 years
	Extortion	2	20 years
EUGENE LOMBARDO	Racketeering	2	20 years
	Conspiracy To Commit Securities Fraud	1	5 years
	Securities Fraud Under Section 10(b)	3	10 years
	Securities Fraud Under Section 17(a)	2	5 years
	Wire Fraud	7	5 years
	Extortion	8	20 years
	Conspiracy To Commit Bank Fraud	1	5 years
	Bank Fraud	1	30 years
CLAUDIO IODICE	Racketeering	2	20 years
	Conspiracy To Commit Securities Fraud	1	5 years
	Securities Fraud Under Section 10(b)	3	10 years
	Securities	2	5 years

	Fraud Under Section 17(a)		
	Wire Fraud	7	5 years
	Extortion	8	20 years
IRWIN SCHNEIDER	Racketeering	2	20 years
	Conspiracy To Commit Securities Fraud	1	5 years
	Securities Fraud Under Section 10(b)	3	10 years
	Securities Fraud Under Section 17(a)	2	5 years
	Wire Fraud	7	5 years
	Extortion	2	20 years
ROBERT SCHWICKRATH	Racketeering	2	20 years
	Extortion	4	20 years
GORDON HALL	Racketeering	2	20 years
	Conspiracy To Commit Securities Fraud	1	5 years
	Securities Fraud Under Section 10(b)	3	10 years
	Securities Fraud Under Section 17(a)	2	5 years
	Wire Fraud	7	5 years

JOE KIRKHAM	Conspiracy To Commit Securities Fraud	1	5 years
	Securities Fraud Under Section 10(b)	1	10 years
	Securities Fraud Under Section 17(a)	1	5 years
	Wire Fraud	7	5 years
JONATHAN LYONS	Conspiracy To Commit Securities Fraud	1	5 years
	Securities Fraud Under Section 10(b)	3	10 years
	Securities Fraud Under Section 17(a)	2	5 years
ARNOLD SCHNEIDER	Conspiracy To Commit Securities Fraud	1	5 years
	Securities Fraud Under Section 10(b)	3	10 years
	Securities Fraud Under Section 17(a)	2	5 years
LAWRENCE SCHNEIDER	Conspiracy To Commit Securities Fraud	1	5 years
	Securities Fraud Under Section 10(b)	3	10 years

	Securities Fraud Under Section 17(a)	2	5 years
SAL TADDEO	Conspiracy To Commit Securities Fraud	1	5 years
	Securities Fraud Under Section 10(b)	3	10 years
	Securities Fraud Under Section 17(a)	2	5 years
MICHAEL MOTSYKULASHVILI	Conspiracy To Commit Securities Fraud	1	5 years
	Securities Fraud Under Section 10(b)	3	10 years
	Securities Fraud Under Section 17(a)	2	5 years
THOMAS SCARPACI	Conspiracy To Commit Securities Fraud	1	5 years
	Securities Fraud Under Section 10(b)	3	10 years
	Securities Fraud Under Section 17(a)	2	5 years
PHIL DEFONTE	Conspiracy To Commit Securities Fraud	1	5 years
EDDIE NAGEL	Conspiracy To Commit Bank	1	5 years

United States Attorney
Southern District of New York

FOR IMMEDIATE RELEASE
APRIL 14, 2000

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PRESS RELEASE

MARY JO WHITE, the United States Attorney for the Southern District of New York, and LEWIS D. SCHILIRO, Assistant Director in Charge of the New York Office of the FBI, announced today the unsealing in Manhattan federal court of an Indictment charging 13 defendants with conspiracy to commit securities fraud, wire fraud, and commercial bribery in connection with a scheme to bribe stock brokers working at two branch offices of MEYERS POLLOCK AND ROBBINS, INC., a now-defunct brokerage firm.

The defendants indicted were MICHAEL PLOSHNICK, the former president of MEYERS POLLOCK AND ROBBINS, INC., along with MEYERS POLLOCK AND ROBBINS, INC. itself and 11 stock brokers who were employed at the firm -- KEITH NELSON, SCOTT SHAY, SAMEH SHERABI, a/k/a "Sam," DANIEL MCGANN, VICTOR VEGA, EDWARD CESPEDES, RICHARD P. SANTORO, a/k/a "Rick," JOSEPH DORTONA, FRANCO DORTONA, CHARLES T. HEEHLER, a/k/a "Tom," and JOHN NALICK.

VEGA, CESPEDES, SHAY, SHERABI and NELSON surrendered today. PLOSHNICK, SANTORO, JOSEPH DORTONA and FRANCO DORTONA are expected to surrender Monday. HEEHLER and NALICK have yet to be scheduled for surrender, and MCGANN notified the Government that he is hospitalized.

The Indictment alleges that in return for a bribe in the form of HealthTech warrants, PLOSHNICK agreed to allow the MEYERS POLLOCK AND ROBBINS firm, including NELSON, SHAY, SHERABI, MCGANN, VEGA, CESPEDES, SANTORO, JOSEPH DORTONA, FRANCO DORTONA, HEEHLER, and NALICK to promote HealthTech securities to their customers. These stock brokers, in turn, allegedly received secret cash payments to induce their customers to purchase HealthTech common stock and later HealthTech warrants. The Indictment also alleges that MEYERS POLLOCK AND ROBBINS and PLOSHNICK charged excessive and undisclosed mark-ups to MEYERS POLLOCK AND ROBBINS customers in connection with the firm's sale of certain HealthTech warrants that it received at no cost.

In connection with the broker-bribery scheme, PLOSHNICK, MEYERS POLLOCK AND ROBBINS, NELSON, SHAY, SHERABI, MCGANN, VEGA, CESPEDES, SANTORO, JOSEPH DORTONA, FRANCO DORTONA, HEEHLER, and NALICK were all charged with one count of conspiracy to commit securities fraud, wire fraud, and commercial bribery and various substantive securities fraud counts. In connection with the excessive and undisclosed mark-up scheme, MEYERS POLLOCK AND ROBBINS and PLOSHNICK were charged with one count of conspiracy to commit securities fraud and one count of substantive securities

fraud.

The Indictment was based on earlier charges brought in the Southern District of New York in November 1997 against 20 defendants, including high-level members and associates of the Genovese Organized Crime Family and the Bonanno Organized Crime Family, several stock brokers, and two officers of HealthTech, a small publicly held company in the physical fitness industry. These defendants were charged with participating in a scheme to unlawfully manipulate the market price of certain securities including securities issued by HealthTech. Based on these charges, 16 of the defendants pled guilty to securities fraud and extortion charges, and two defendants, Gordon Hall, the Chairman of HealthTech, and Michael Motsykulashvili, a MEYERS POLLOCK AND ROBBINS stock broker, were convicted of racketeering, securities fraud, and wire fraud violations after a seven-week trial.

The Indictment charges that in late 1996, Hall hired stock promoters including Irwin Schneider, a disbarred securities attorney, and Eugene Lombardo, as associate of the Bonanno Organized Crime Family, who agreed to artificially increase the market price of HealthTech securities. To accomplish this unlawful price increase, the Indictment charges that Lombardo and others paid certain stock brokers working at MEYERS POLLOCK AND ROBBINS to sell shares of HealthTech securities in return for bribes, in breach of the stock brokers' fiduciary duties to their customers. Among the stock brokers who received these bribes were NELSON,

SHAY, SHERABI, MCGANN, VEGA, CESPEDES, SANTORO, JOSEPH DORTONA, FRANCO DORTONA, HEEHLER, and NALICK who worked at a MEYERS POLLOCK AND ROBBINS branch office in New Hyde Park, Long Island, New York, and sold HealthTech stock to their unsuspecting customers.

The Indictment alleges that as a result of the scheme, the price and trading volume of HealthTech stock rose dramatically in January 1997. On or about January 2, 1997, the day the stock brokers began recommending HealthTech stock to their customers, HealthTech's trading volume increased over 250% as compared to the prior day's trading. The closing price of HealthTech stock also increased 53% form the prior day's closing price. For the month of January 1997, 2,314,156 shares of HealthTech common stock were traded, as compared to only 642,845 shares for the month of December 1996. Trading in the common stock at similar levels was sustained for several months.

The Indictment further alleges that in February 1997, due to certain disputes at the MEYERS POLLOCK AND ROBBINS branch office with its owner Jonathan Lyons, Irwin Schneider entered into an illegal agreement with PLOSHNICK, the president of MEYERS POLLOCK AND ROBBINS, whereby Irwin Schneider agreed to provide PLOSHNICK with undisclosed compensation in the form of 200,000 HealthTech warrants for a nominal amount. PLOSHNICK and Irwin Schneider discussed ways of concealing PLOSHNICK's receipt of the 200,000 warrants by: (a) falsely characterizing PLOSHNICK as a so-called "financial advisor" to HealthTech, and falsely claiming that the

200,000 HealthTech warrants were payment for services rendered to HealthTech, and (b) putting the warrants in the name of PLOSHNICK's children as nominees.

The Indictment further alleges that in April 1997, PLOSHNICK arranged for the stock brokers to continue their bribery scheme at another MEYERS POLLOCK AND ROBBINS branch office located at 100 Wall Street in Manhattan. In furtherance of the scheme, PLOSHNICK received 600,000 HealthTech warrants at no cost from HealthTech, of which 200,000 were sold to MEYERS POLLOCK AND ROBBINS customers and the proceeds retained by MEYERS POLLOCK and PLOSHNICK, and 400,000 were sold to MEYERS POLLOCK AND ROBBINS customers and the proceeds used to pay bribes to stock brokers at the new MEYERS POLLOCK AND ROBBINS branch office, including NELSON, SHAY, SHERABI, MCGANN, VEGA, and CESPEDES.

The Indictment charges that as a result of the bribery scheme, the trading price and volume for HealthTech warrants rose significantly from April 1997 through June 1997. The Indictment charges that the price of the HealthTech warrants during April 1997 rose from approximately $.25 cents to $.625 cents. Moreover, in April 1997, MEYERS POLLOCK AND ROBBINS stock brokers were responsible for almost 70% of all retail customer purchases in HealthTech warrants, and during the months of May and June 1997, the figure reached to over 80%.

The Indictment alleges that PLOSHNICK entered into an

after-the-fact bogus consulting agreement with HealthTech to cover the illegal transfer of 600,000 HealthTech warrants. The Indictment also charges that the consulting agreement falsely provided that MEYERS POLLOCK AND ROBBINS would provide various services to HealthTech when in fact, none of the services were provided or intended to be provided by PLOSHNICK, MEYER POLLOCK AND ROBBINS, or any MEYERS POLLOCK AND ROBBINS branch office.

The Indictment also alleges that after grand jury subpoenas were issued in October 1997 in connection with the investigation, PLOSHNICK and MEYERS POLLOCK AND ROBBINS attempted to cover up their fraud by causing a letter to be sent to customers of MEYERS POLLOCK AND ROBBINS advising them that "[a]t the time [they] purchased [HealthTech] shares or warrants Meyers Pollock Robbins, Inc. may have entered into an investment banking relationship with the company, in addition to being a market marker in the common stock and warrants." The Indictment charges that this belated letter failed to disclose that the purported "consulting agreement" between MEYERS POLLOCK AND ROBBINS and HealthTech was fictitious.

The defendants face the following maximum sentences if convicted on all charges:

MICHAEL PLOSHNICK	Conspiracy to commit Securities Fraud	2	5 years
	Securities Fraud	2	10 years

KEITH NELSON	Conspiracy to commit Securities Fraud	1	5 years
	Securities Fraud	2	10 years
SCOTT SHAY	Conspiracy to commit Securities Fraud	1	5 years
	Securities Fraud	2	10 years
SAMEH SHERABI	Conspiracy to commit Securities Fraud	1	5 years
	Securities Fraud	2	10 years
DANIEL MCGANN	Conspiracy to commit Securities Fraud	1	5 years
	Securities Fraud	2	10 years
VICTOR VEGA	Conspiracy to commit Securities Fraud	1	5 years
	Securities Fraud	2	10 years
EDWARD CESPEDES	Conspiracy to commit Securities Fraud	1	5 years
	Securities Fraud	2	10 years
RICHARD P. SANTORO	Conspiracy to commit Securities Fraud	1	5 years
	Securities Fraud	2	10 years

JOSEPH DORTONA	Conspiracy to commit Securities Fraud	1	5 years
	Securities Fraud	2	10 years
FRANCO DORTONA	Conspiracy to commit Securities Fraud	1	5 years
	Securities Fraud	1	10 years
CHARLES T. HEEHLER	Conspiracy to commit Securities Fraud	1	5 years
	Securities Fraud	2	10 years
JOHN NALICK	Conspiracy to commit Securities Fraud	1	5 years
	Securities Fraud	2	10 years
MEYERS POLLOCK ROBBINS, Inc.	Conspiracy to commit Securities Fraud	2	[????]
	Securities Fraud	2	$2,500,000 Fine

In connection with the November 1997 Indictment, defendants Hall and Motsykulashvili were convicted after trial in May 1999. The 16 defendants who have pled guilty entered their guilty pleas during 1999. These defendants are as follows:

-- GORDON HALL, former chairman of HealthTech, was

convicted after trial of 12 counts of racketeering, securities fraud, and wire fraud. Hall was sentenced to seven years and three months in prison, ordered to pay approximately $3.8 million in restitution, and barred from working in the securities industry. He is incarcerated.

-- MICHAEL MOTSYKULASHVILI, a/k/a "Mike," a/k/a "Mike the Russian," was convicted of the same charges as Hall. MOTSYKULASHVILI is awaiting sentencing and faces a maximum of 20 years in prison.

-- ROSARIO GANGI, a/k/a "Rossi," a/k/a "Ross," a Capo in the Genovese Organized Crime Family, pled guilty to conspiring to manipulate the price of HealthTech International, Inc. and to participating in four conspiracies to commit extortion that grew out of and were related to the scheme to manipulate the price of certain securities. GANGI was sentenced to eight years and one month in prison and ordered to pay $150,000 in restitution and is incarcerated.

-- FRANK LINO, a/k/a "Curly," allegedly a Capo in the Bonanno Organized Crime Family, pled guilty to participating in the conspiracy to manipulate the price of HealthTech securities and to one related extortion conspiracy. LINO was sentenced to four years and nine months in prison and ordered to pay $120,000 in restitution and is incarcerated.

-- ERNEST MONTEVECCHI, a/k/a "Butch," allegedly a

soldier in the Genovese Organized Crime Family, pled guilty to participating in the conspiracy to manipulate the price of HealthTech securities and to two related extortion conspiracies. MONTEVECCHI was sentenced to five years and three months in prison and ordered to pay $125,000 in restitution and is incarcerated.

-- JOHN CERASANI, a/k/a "Boobie," allegedly a soldier in the Bonanno Organized Crime Family, pled guilty to participating in a conspiracy to extort the owner and employees of the New Hyde Park branch of the brokerage firm of Meyers Pollock. CERASANI was sentenced to four years and nine months in prison and ordered to pay a $6,000 fine and is incarcerated.

-- EUGENE LOMBARDO, a/k/a "Gene," allegedly an associate of the Bonanno Organized Crime Family, pled guilty to the same charges as GANGI and was sentenced to eight years in prison and ordered to pay $200,000 in restitution and is incarcerated.

-- IRWIN SCHNEIDER, one of the stock promoters, pled guilty pursuant to a cooperation agreement with the Government to conspiracy to violate the RICO statute. He testified for the Government at trial. He faces a maximum sentence of 20 years' imprisonment under the statute.

-- ROBERT SCHWICKRATH, a/k/a "Bobby," pled guilty to participating in two extortion conspiracies related to the defendants' efforts to control another brokerage firm, TAJ Global Equities, Inc. In addition, SCHWICKRATH pled guilty to

participating in an unrelated conspiracy to manipulate the price of securities. SCHWICKRATH was sentenced to three years and 10 months in prison and ordered to pay $82,000 in restitution and is incarcerated.

-- ARNOLD SCHNEIDER and LAWRENCE SCHNEIDER, brokers who, along with MOTSYKULASHVILI, were in charge of the Meyers Pollock offices where the securities were sold, pled guilty to participating in a conspiracy to commit securities fraud and were each sentenced to two years and three months in prison and ordered to pay $100,000 each in restitution and are both incarcerated.

-- PHIL DEFONTE, SAL TADDEO and THOMAS SCARPACI also pled guilty to conspiracy to commit securities fraud and were sentenced as follows: DEFONTE was sentenced to one year and nine months in prison and ordered to pay $20,000 in restitution, TADDEO was sentenced to a year and sex months in prison and ordered to pay $10,000 in restitution, and SCARPACI was sentenced to two years in prison and fined $10,000. DEFONTE, TADDEO, and SCARPACI are incarcerated.

-- JONATHAN LYONS, a broker who ran the New Hyde Park office of MEYERS POLLOCK AND ROBBINS in late 1996 and early 1997, pled guilty to conspiracy to commit securities fraud and faces a maximum sentence of 5 years' imprisonment under the statute, and is awaiting sentencing.

-- JOSEPH KIRKHAM, formerly the Vice President of

HealthTech in charge of its medical operations, pled guilty to misprision of a felony and was sentenced to one year of probation, with six months of home confinement, and ordered to pay $10,000 in restitution.

-- JOSEPH ZIMBARDO pled guilty to conspiracy to commit extortion and was sentenced to three years and 10 months in prison and is incarcerated.

-- DANIEL GUMA pled guilty to extortion and was sentenced to two years and three months in prison and is incarcerated.

Two other defendants, CLAUDIO IODICE and EDMOND NAGEL, are awaiting trial.

Ms. WHITE praised the efforts of all of the law enforcement agencies involved, and particularly commended the efforts of the FBI and NYPD task force that is principally responsible for investigating the criminal activities of the Genovese Family. Ms. WHITE also thanked the Criminal Prosecution Assistance Group of NASD Regulation, Inc., and the United States Securities and Exchange Commission for their assistance.

Assistant United States Attorney CELESTE KOELEVELD and Special Assistant United States Attorney JASON SABOT are in charge of the prosecution.

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U.S. Department of Justice

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June 16, 1999

PRESS RELEASE

89 DEFENDANTS INDICTED IN STOCK FRAUD SCHEMES THAT NETTED OVER 100 MILLION DOLLARS

ZACHARY W. CARTER, United States Attorney for the Eastern District of New York, **LEWIS D. SCHILIRO**, Assistant Director-in-Charge of the Federal Bureau of Investigation in New York, **LEE R. HEATH**, New York Postal Inspector in Charge, **RICK A. SCHMIDT**, Chief, Internal Revenue Service, Criminal Investigation Division (Brooklyn), **CARMEN J. LAWRENCE**, Regional Director, Northeast Regional Office of the Securities and Exchange Commission and **MARY L. SCHAPIRO**, President of NASD Regulation, Inc., today announced

three indictments of 89 defendants for participation in stock fraud schemes that defrauded thousands of public investors of over 100 million dollars. The crimes alleged in the three indictments involve nine corrupt brokerage firms and twenty "microcap" stocks that were sold from boiler rooms through various illegal means. These cases are the result of multi-year, joint investigations conducted by the United States Attorney's Office, the FBI, the Postal Inspection Service, the IRS, the SEC, the NASD, the New York State Police and the New Jersey Attorney General's Office.

1. UNITED STATES V. CATOGGIO, ET AL.

The indictment in United States v. Catoggio, et al., 98 CR 1129S (RJD), charges 55 defendants with a massive stock fraud scheme that extended over an eight year period, involved four separate brokerage houses, and resulted in the manipulation of the stocks and/or warrants of over 17 companies. The defendants are charged with securities fraud conspiracies, mail and wire fraud conspiracies, money laundering, obstruction of justice, and two RICO charges.

The scheme was led by defendants ROBERT CATOGGIO and ROY AGELOFF, who controlled four brokerage firms used to carry out the scheme: (1) Hanover, Sterling & Co., Ltd. ("Hanover"), (2) Norfolk Securities Corp. ("Norfolk"), (3) PCM Securities, Limited, L.P. ("PCM"), which changed its name in January 1998 to Royal Palm Investments, Ltd. ("Royal Palm"), and (4) Capital Planning Associates, Inc. ("CPAI"). 52 defendants worked at these brokerage firms as brokers, traders and operating personnel. Defendant DONALD MESSINGER was a stock promoter.

The defendants are charged with utilizing various means to manipulate the market price of the securities of 17 companies that traded their securities on the OTC Bulletin Board and the Nasdaq small cap stock market, and engaged in other deceptive sales practices with respect to public investors. The names of the companies whose securities were the subject of manipulation are listed

in the indictment in paragraph 7.

As alleged in the indictment, the defendants' frauds with respect to each of the 17 companies and the public followed a similar pattern: defendants ROBERT CATOGGIO and ROY AGELOFF, together with others, arranged to acquire control over large blocks of securities (referred to as "House Stocks") of various small and start-up companies, as well as companies that did no business at all. CATOGGIO and AGELOFF frequently acquired the House Stocks for litue consideration. On certain occasions, CATOGGIO and AGELOFF acquired House Stocks cheaply by paying kickbacks to principals of the House Stock issuers; on other occasions, the House Stock was obtained even cheaper, by stealing the stock from the issuer.

As charged in the indictment, CATOGGIO and AGELOFF, having acquired the House Stocks, then created artificial market demand for them through a variety of techniques. None of these techniques was disclosed to investors at the time of their purchase of the House Stocks or thereafter because disclosure would reveal the undesirability of the House Stocks and would thus result in the unraveling of the scheme.

One technique that CATOGGIO and AGELOFF used to create demand and to defraud consumers was to pay excessive undisclosed commissions to brokers at the brokerage firms that they controlled, including Hanover, Norfolk, PCM and CPAI, based on the amount of the particular House Stock a broker sold to an investor. These commissions, which could be 20-30% of the price of the House Stock, encouraged brokers to tout aggressively the House Stock to the public. Such commissions were not paid to brokers when selling non-House Stock to investors or when buying House Stock from consumers. Instead of disclosing these kickbacks to the public, which would discourage investors from purchasing the stock at the artificially inflated purchase price,

the brokers routinely informed their customers that a nominal or no commission would be charged.

Another technique the defendants are charged with employing at the brokerage firms in order to create artificial market demand and defraud investors was to augment the ranks of registered brokers with unregistered brokers and cold callers, who routinely falsely represented to investors that they were registered brokers and solicited purchases of House Stock. Brokers who had been barred by the National Association of Securities Dealers from participating in the securities business, and brokers who were not registered at the brokerage firms due to customer complaints and disciplinary histories, used the names of registered brokers at the brokerage firms in dealing with the public. Further, although CATOGGIO was barred by the SEC from the securities business in September 1995, he continued to engage in the securities business and used front men to run the brokerage firms.

The defendants also are charged with employing high-pressure, false, and misleading sales pitches and scripts to convince investors to purchase House Stock. Brokers assured investors that the price of the House Stocks would rise quickly and made exalted claims about the companies' business prospects, although the companies routinely did little or no business.

Finally, the defendants are charged with recommending a better-known and more established non-House Stock to potential new customers to lure them to open an account at one of the brokerage firms. Once a customer opened an account and purchased the non-House Stock, the broker switched the customer into a House Stock, routinely using a false and misleading sales pitch designed to make the consumer believe that the House Stock was a better investment than the non-House Stock, and without disclosing the broker's personal financial interest in the sale of House Stock.

When the price of the House Stock rose as a result of these techniques, CATOGGIO and AGELOFF, and other members of the scheme who had the stock, sold it from their nominee accounts to the brokerage firms' customers at a substantial profit. The brokerage firms also pocketed a percentage of the proceeds of these House Stock sales to consumers. The defendants obtained tens of millions of dollars in profits through this scheme.

The price of the House Stocks was artificially maintained by a variety of means designed to insulate the House Stocks from the adverse pressure of a lack of market demand, which would cause the stock price to collapse and the scheme to be detected. These techniques included: (a) using high-pressure tactics and false and misleading statements to persuade customers not to sell House Stocks; (b) failing to take and execute customer orders to sell House Stocks; and (c) executing a sale of a House Stock only if it could be "crossed" with a purchase of the same stock by another customer. Each of the brokerage firms enforced a secret crossing policy with respect to the House Stocks.

CATOGGIO and AGELOFF and other members of the scheme are charged with laundering millions of dollars of proceeds of securities, mail and wire fraud through domestic and offshore accounts. One of the techniques they used to obtain access in the United States to the money generated from their illegal scheme was to wire the proceeds to casinos in Nevada, where the money was then withdrawn as cash.

Part of the case involved an undercover operation run by the FBI and the Eastern District of New York U.S. Attorney's Office in the winter of 1996. CATOGGIO and DIBELLA arranged for an FBI undercover agent, posing as the manager of a money market firm, to purchase $2.5 million of First Colonial Ventures, Ltd. stock by purported customers of the money management

firm at a price that the defendants would artificially inflate by market manipulation. CATOGGIO and DIBELLA agreed to pay undisclosed kickbacks totaling 25% of the purchase price of the First Colonial stock to the undercover agent in order to induce him to purchase the stock and to hold it in the accounts of his purported customers to avoid sales that would depress the artificially inflated market value.

On February 20, 1996, CATOGGIO met with the undercover agent to persuade him to purchase the inflated shares of First Colonial in exchange for the kickback. In a recorded conversation, CATOGGIO explained that so long as the undercover agent and his customers did not seek to sell the stock, for which there was no market, the undercover agent would make his money up front and be able to move on to the next stock fraud, as CATOGGIO had done when he was at Hanover. As charged in the indictment, CATOGGIO explained:

> Once you buy it, you own it, you know. You make your money and you move on to the next one. You just hold it. Your clients don't lose the money, but it don't go to the, it's not gonna, it's not like you'll be able to sell it to the street. . . .
>
> We took eight deals out at Hanover, I never read one of the prospectuses. . . . I mean the reality of it is, without pulling each other's chain, you're doing this to make money. You're not doing this because it's gonna be the next IBM.

CATOGGIO and DIBELLA were charged in 1997 with the fraud involving First Colonial and have pled guilty to this scheme, which forms part of the current RICO charges.

This investigation has already resulted in the guilty pleas of 15 individuals. One such defendant, THOMAS BOCCIERI, Esq., was a staff attorney with the New York branch of the Securities and Exchange Commission in the 1970s. On June 7, 1999, he pled guilty in this district to mail fraud. BOCCIERI had been retained to represent Communication Corporation of America

("CCAK"). In the winter of 1997, CCAK engaged in a private placement offering of its stock, which was intended to generate start-up capital. The offering occurred on January 9, 1997 and was for 1,250,000 shares of CCAK stock at $.40/share. In May 1997, BOCCIERI, knowing that he was unauthorized to do so, caused CCAK's transfer agent to issue 42,500 shares of CCAK stock, which was then trading at $4, to be issued to himself. CCAK discovered the fraud and obtained the stolen shares back from BOCCIERI.

On June 8 and 9, 1999, BARRY MIELE and MARCELO QUINTERO, who both worked at CPAI, as well as DOMINICK FRONCILLO and ALAN KOOP, pled guilty to securities fraud conspiracy relating to Transun International Airways, Inc. ("TSUN"). Boccieri had been retained to represent TSUN in connection with a private placement of stock worth $900,000 in December 1997. MIELE, QUINTERO, FRONCILLO and KOOP defrauded TSUN by sending it forged promissory notes as security for issuance of stock in the TSUN private placement. As a result, of the $900,000 that it expected to raise in the private placement, TSUN received only $150,000 from the offering, far less than it needed to begin operations. As the defendants admitted in their pleas, the TSUN stock which they obtained was then artificially manipulated and sold to the public at inflated prices. MIELE also pled guilty to manipulating the stock of CCAK in a separate conspiracy charge to which he pled guilty. These five defendants each face 5 years imprisonment, 3 years of supervised release, a $250,000 fine and an order of restitution on each conspiracy count. As part of their pleas, the defendants are already obliged to pay more than half a million dollars in restitution as part of their sentence.

The charges in the current indictment carry the following maximum sentences: as to each RICO count, 20 years imprisonment, 3 years of supervised release, a $250,000 fine (or twice

the gross gain or loss) and an order of restitution; as to each money laundering count, 20 years imprisonment, 3 years of supervised release, a $250,000 fine (or twice the gross gain or loss) and an order of restitution; and as to each conspiracy to commit securities, mail and wire fraud count: 5 years imprisonment, 3 years of supervised release, a $250,000 fine (or twice the gross gain or loss) and an order of restitution.[1]

The case is being prosecuted by Assistant United States Attorneys Andrew Weissmann and Jonathan Mothner.

2. UNITED STATES V. DIONISIO, ET AL.

The indictment in United States v. Dionisio, et al., charges 23 defendants with participating in a large-scale stock fraud and money laundering scheme that was controlled and directed by a confederation of traditional organized crime and Russian Organized Crime. This scheme generated more than ten million dollars in illegal proceeds by defrauding hundreds of innocent victims who, through false and misleading, high-pressure sales pitches, were induced by the defendants to invest in worthless stock.

The scheme was led by defendants DOMINICK DIONISIO and ENRICO LOCASIO, associates of the Colombo Organized Crime family, who placed and supervised crews of registered and unregistered brokers and unlicensed cold callers in boiler rooms located in the branch offices of the following brokerage firms located in the New York area: Global Strategies Group, Inc. ("Global"); Amerivet Dymally Securities ("Amerivet"); J.S. Securities, later renamed First National Equity Corporation (together, "First National"); and Three Arrows Capital Corporation ("Three

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[1] The charges contained in each of the indictments announced today are merely accusations, and the defendants are presumed innocent unless and until proven guilty.

Arrows"). Defendant YAKOV SLAVIN, an associate of the Bor Russian Organized Crime Group, joined with DIONISIO and LOCASIO in placing and supervising crews of registered and unregistered brokers and cold callers in boiler rooms at branch offices of Global, Amerivet and First National.

The defendants are charged with controlling and manipulating the market price of three stocks: Legends Sports, Inc.; Orlando Supercard, Inc; and City Services, Inc. The conspirators gained secret control of substantially all of the freely tradeable shares of these companies. Various means were then used to manipulate the price of and create an artificial demand for the stocks. In the boiler rooms, defendant brokers and cold callers posing as registered brokers sold stock to the public by making false and misleading statements concerning, among other things, the nature and prospect of the companies' stock and the true compensation paid to the brokers. These brokers were given substantial cash payoffs to sell the worthless stock.

Through these activities, the boiler rooms generated millions of dollars of illegal profits which, utilizing nominee accounts, the defendants and other co-conspirators disbursed through cash payments designed to conceal and hide the nature, location, source, ownership and control of the funds. As a result of these fraudulent schemes, the investing public suffered more than $10 million in losses.

Besides DIONISIO, LOCASCIO and SLAVIN, the defendants include registered brokers BRIAN DUFFY, GERARD BRUZZESE, CHARLES DIMAGGIO, SIMUEL STEVENSON and MICHAEL HOUSTON who not only sold stock through fraudulent means but received extra cash payments for allowing unregistered brokers and unlicensed cold callers to use their names to falsely identify themselves to unwitting investors as a properly registered broker.

Defendants JACK BASILE, CHRISTOPHER WOLF, RUSLAN DZHIKIYA, ALEX LEVIN and DENIS YUROFSKY supervised the operation of the various boiler rooms, while the defendants CHRISTOPHER MORMANDO, FRANK RAGUSA, JOSEPH LANNI, JOHN PUGLIESE, ANTHONY TOLENDINI, MICHAEL CERRATO, ALEXANDER MUCHNIK and MYRON LNU participated in the sale of the stocks falsely identifying themselves as registered brokers. The defendant JOHN MANION was a stock promoter.

The defendants are charged in a six count indictment with conspiracy to commit securities, mail and wire fraud (Count One), substantive securities fraud (Counts Two through Four), conspiracy to commit money laundering (Count Five), and conspiracy to engage in unlawful monetary transactions (Count Six). The charges in the indictment carry the following maximum penalties: as to the conspiracy to commit securities, mail and wire fraud count, 5 years imprisonment, 3 years of supervised release, a $250,000 fine (or twice the gross gain or loss) and an order of restitution; as to each securities fraud count, 10 years imprisonment, 3 years of supervised release, a $1,000,000 fine (or twice the gross gain or loss) and an order of restitution; and as to the money laundering conspiracy and unlawful monetary transaction conspiracy counts, 20 years imprisonment, 3 years of supervised release, a $250,000 fine (or twice the gross gain or loss) and an order of restitution. The defendants also face criminal forfeiture of approximately $10 million in real or personal property traceable to the proceeds of the fraudulent schemes.

The case is being prosecuted by Assistant U.S. Attorneys Patricia E. Notopoulos and Jonathan S. Sack. Assistant U.S. Attorney Susan L. Riley is handling the criminal forfeiture allegation.

3. UNITED STATES V. WOLF, ET AL.

The indictment in United States v. Wolf, et al., 99 CR 139(S-1)(NG), charges 11 defendants with having participated in a scheme to manipulate the price of the common stock of Auxer Industries, Inc. ("Auxer"). Through the scheme, the defendants sold the public approximately 8 million dollars of virtually worthless stock.

During the period of the scheme, from approximately April 1995 to December 1995, Auxer, claimed to be developing and marketing a new additive to motor oil, Formula 2000, that improved the operation of automobile engines. Auxer stock traded on the Over-the-Counter Bulletin Board market.

The indictment charges that, in furtherance of the fraudulent scheme, CHRISTOPHER WOLF and co-conspirators secretly gained control of large blocks of the stock of Auxer, a Ridgewood, New Jersey-based company. This control enabled WOLF and co-conspirators to exercise substantial control over the stock price. Having secured this control, WOLF and his co-conspirators then artificially inflated demand for the stock by inducing brokers -- by means of secret payoffs -- to recommend and sell Auxer stock to the public. Once the price of the stock was artificially raised and maintained, WOLF and co-conspirators sold the stock they secretly controlled, generating millions of dollars in secret profits which were then disbursed and concealed through transfers among numerous bank accounts, including accounts in the name of off-shore shell companies. When the participants in the scheme had sold most of their shares, they ceased paying brokers to recommend the stock to investors, and the price of Auxer stock dropped sharply, causing unwitting investors to lose more than $8 million.

According to the indictment, WOLF carried out the scheme by recruiting a group of

brokers and cold callers to staff a brokerage office at 63 Wall Street, New York, New York, which originally operated under the name J.S. Securities, Inc. ("JS") and a short time later was renamed Vision Investment Group, Inc. ("Vision"). Among the individuals recruited to hype Auxer stock to the public at JS and Vision were the defendants WILLIAM BATTISTA, a/k/a "Billy Bats," JAIRO BAQUERO, CHANCE MIGLINO, JOSEPH DEMARCO, ADAM EMMINO, PETER LOMBARDO, VINCENT LOCOMBO, MICHAEL CORULLA and ROBERT HINES. DEMARCO, BAQUERO, and CORULLA were registered brokers at JS and Vision; HINES was a registered broker at Vision. BATTISTA, MIGLINO, EMMINO, LOMBARDO and LOCOMBO were not registered brokers at either of the firms, though they recommended and sold stock to the public anyway, in violation of federal securities laws and regulations. The defendant MARY BAUM furthered the scheme by assisting WOLF and the other defendants complete the necessary paperwork to execute fraudulent purchases of Auxer stock.

The indictment charges that, at JS and Vision, WOLF and the other defendants pumped up the price of Auxer stock by providing investors with false and misleading information about Auxer's business activities and financial condition. This information was contained in scripts, or "pitch sheets," used by the defendants when pitching Auxer stock to the public. In addition to convincing investors to buy Auxer stock on the basis of false information, WOLF and other co-conspirators executed many purchases without any authorization from the investors. WOLF and his co-conspirators also directed that certain stocks be sold without ever obtaining prior approval from the customers.

The indictment further charges that JS and Vision hired as brokers and cold callers many individuals who were not licensed to sell stock or were not registered with the NASD to sell

stock at JS or Vision. Because they could not lawfully recommend or sell stock to the public, they used names other than their own so as to identify themselves falsely as registered brokers of JS or Vision when speaking with the public.

The defendants are charged in a three count indictment with conspiracy to commit securities fraud (Count One), substantive securities fraud (Count Two), and conspiracy to commit money laundering (Count Three). The charges in the current indictment carry the following maximum penalties: as to the conspiracy to commit securities fraud count, 5 years imprisonment, 3 years of supervised release, a $250,000 fine (or twice the gross gain or loss) and an order of restitution; as to the securities fraud count, 10 years imprisonment, 3 years of supervised release, a $1,000,000 fine (or twice the gross gain or loss) and an order of restitution; and as to the money laundering conspiracy count, 20 years imprisonment, 3 years of supervised release, a $250,000 fine (or twice the gross gain or loss) and an order of restitution. The defendants also face criminal forfeiture of millions of dollars in real or personal property traceable to the proceeds of the fraudulent schemes.

The case is being prosecuted by Assistant U.S. Attorneys Jonathan S. Sack and Patricia E. Notopoulos. Assistant U.S. Attorney Susan L. Riley is handling the criminal forfeiture allegation.

* * * *

In commenting on the indictments, United States Attorney ZACHARY W. CARTER stated:

> These cases are striking both because of the breadth of the schemes -- involving at least 100 corrupt brokers selling worthless stocks from more than a dozen boiler rooms -- and the widespread

> impact of the fraud. Thousands of investors throughout the United States lost more than $100 million because of the defendants' fraudulent practices.
>
> In addition, these cases demonstrate Organized Crime's efforts to infiltrate our securities markets. As law enforcement has begun to shut off many of the more traditional areas of criminality from exploitation by Organized Crime, both Italian and Russian crime families have begun to look at the securities markets as a new "growth industry" for their illegal enterprises. These prosecutions should send the strong and clear message that we will be particularly vigilant to ensure that our nation's securities markets remain free of Organized Crime's pernicious influence.

MR. CARTER thanked the New York State Police and the New Jersey Attorney General's Office for their assistance in these investigations.

CARMEN J. LAWRENCE, Regional Director, Northeast Regional Office of the Securities and Exchange Commission stated:

> We commend the United States Attorney's Office for the Eastern District of New York and the other law enforcement agencies for the important criminal actions announced today. These actions, along with the related civil actions that the SEC is bringing today and has brought previously, are another example of effective coordination and cooperation among the various agencies. These cases reflect the commitment of law enforcement and regulatory authorities to maintaining the integrity of the nation's securities markets and to combat fraud in the microcap market.

MARY L. SCHAPIRO, President of NASD Regulation, Inc., stated:

> Today's action by United States Attorney Zachary Carter demonstrates a joint commitment to rid the securities markets of manipulative and fraudulent conduct. The indictments of these 89 defendants will in the end make the markets safer by sending a clear message to those who would victimize investors that they will be brought to justice. We will continue to work closely with law enforcement agencies to preserve the integrity of our markets and keep them worthy of investors' trust and confidence.

The defendants will be arraigned today at the United States Courthouse in Brooklyn by Magistrate Judge Steven M. Gold.

UNITED STATES V. CATOGGIO, ET AL., 98 CR 1129 (S-1) (RJD)

DEFENDANT	DOB	ADDRESS
ROY AGELOFF	9/19/59	5224 PRINCETON WAY BOCA RATON, FL
ROBERT CATOGGIO	9/2/58	INCARCERATED
STEPHEN AGNESE	8/2/71	284 ELLSWORTH AVENUE STATEN ISLAND, NY
ARTHUR ANDREW ALONZO III	9/22/69	760 GLOUCHESTER STREET BOCA RATON, FL
JOHN ASARO	1/7/64	106 SECOND COURT STATEN ISLAND, NY
RANDAL ASHENFARB	3/14/59	65 UNCAS AVENUE STATEN ISLAND, NY
ROCCO M. BASILE	2/21/68	1433 73rd STREET BROOKLYN, NY
WILLIAM J. BATTISTA	5/10/72	2040 86th STREET BROOKYLN, NY 9907 4th AVENUE BROOKLYN, NY
MICHAEL A. BENGEN	11/13/67	506 COVINGTON AVENUE, APT 2N3, BROOKLYN, NY
JOHN BESARANY	2/24/68	23 SUNRISE WAY TOWACO, NJ
FABIO BORGOGNONE	4/69	6019 21st AVENUE BROOKLYN, NY 208 OLD INDIAN ROAD MILTON, NY
NICHOLAS BOSCO	7/20/69	16 TWIN LAKES DRIVE COLT NECK, NJ

DEFENDANT	DOB	ADDRESS
NEIL H. BRAUNER	1/21/71	9087 RUTLEDGE AVENUE BOCA RATON, FL
NICHOLAS A. BRIGANTE	10/16/66	1951-A W. 9th ST, BKLYN.
BRENT CALDERONE LONGO	5/13/73	83 GREENPORT STREET STATEN ISLAND, NY
RONALD J. CATOGGIO	5/17/53	17847 HEATHER RIDGE LANE BOCA RATON, FL 9691 ARBOR OAKS COURT BOCA RATON, FL
ANTHONY CAVICCHIO	12/17/70	824 EDGEGROVE AVENUE STATEN ISLAND, NY
JOHN S. CLAUDINO	8/29/71	1960 BAY RIDGE AVENUE BROOKLYN, NY 15 SLOAN PLACE BROOKLYN, NY
DAMON GERARD COHEN	3/21/68	70 HUDSON STREET HOBOKEN, NJ
WILLIAM E. COSIDENTE, JR.	7/6/64	491 WINCHESTER AVENUE STATEN ISLAND, NY
RONALD C. CROPPER, JR.	1/24/63	115 AMSTERDAM AVENUE STATEN ISLAND, NY
JOSEPH DIBELLA	1/13/66	INCARCERATED
DAVID DUNHAM	1/20/73	354 BEACH AVENUE STATEN ISLAND, NY
JONATHAN MICHAEL DURINDA	10/11/75	94 GARY PLACE STATEN ISLAND, NY
RUI REIS FIGUERIREDO	4/15/70	11 PICARDY LANE SYOSSET, NY

DEFENDANT	DOB	ADDRESS
ROBERT FIGUEROA, JR.	4/10/69	39 COUNTRY LANE STATEN ISLAND, NY
VITO GILL	5/24/72	1540 NE 142nd STREET N. MIAMI, FL
VALERY GOLDBERG	8/9/59	157 E. 57th STREET NEW YORK, NY
GREGORY GROELLER	5/3/74	235 HART AVENUE STATEN ISLAND, NY
THOMAS GUCCIARDO	2/18/69	163-28 98th STREET HOWARD BEACH, NY
JOHN L. LEMBO, III	8/22/69	3021 NE 46th STREET FORT LAUDERDALE, FL
RICO LOCASCIO	4/15/70	86 GARRETSON AVENUE STATEN ISLAND, NY
MARK MANCINO	2/23/67	10945 RAVEL COURT BOCA RATON, FL
PAUL S. MEDAGLIA	6/19/69	285 STILLWELL LANE SYOSETT, NY
DONALD MESSINGER	UNKNOWN	UNKNOWN
CHRISTOPHER L. MIANO	6/24/77	2751 NE 57th STREET FORT LAUDERDALE, FL
VINCENT MINERVA	2/21/69	2529 E. 64th STREET BROOKLYN, NY
CHRISTOPHER MORMANDO	3/3/70	16 MANDY COURT STATEN ISLAND, NY
JAIME SCOTT MORRILL	10/30/72	52 RUSSEK DRIVE STATEN ISLAND, NY
JOEL NAZARENO	6/30/68	55 DAHLGREN PLACE, APT 3B BROOKLYN, NY
VITO PADULO	3/15/62	333 PEARL STREET, APT 15D NEW YORK, NY

DEFENDANT	DOB	ADDRESS
MICHAEL ANTHONY PERRINE	1/26/60	15 PORTLAND PLACE STATEN ISLAND, NY
SCOTT PICININNI	8/12/68	10606 MAPLE CHASE DRIVE BOCA RATON, FL
FRANK J. PIZZOLATO	3/26/63	4100 N. OCEAN DRIVE SINGER ISLAND, FL 183 WOODBINE AVENUE STATEN ISLAND, NY
THOMAS E. PLAMENCO	1/10/67	7918 10th AVENUE BROOKLYN, NY 6113 TOWN COLONY DRIVE BOCA RATON, FL
JOSEPH ROSETTI	12/8/68	137-37 82nd STREET HOWARD BEACH, NY
KEITH RUFFLER	10/14/59	33 E. BROADWAY STATEN ISLAND, NY
KIRK RUFFLER	6/30/61	6 GREENBRIAR LANE PERRINEVILLE, NJ
MICHAEL SCARAMELLINO	6/15/67	7083 ST ALBANS DRIVE BOCA RATON, FL
JOSEPH C. SCARFONE, JR.	10/21/68	1121 N. VENETIAN DRIVE MIAMI, FL
RICHARD A. SCARSELLA	3/30/62	UNKNOWN
PAUL TAHAN	11/20/68	231 77th STREET BROOKLYN, NY 6503 N. MILITARY TRAIL FORT LAUDERDALE, FL
MICHAEL TROCCHIO	7/13/72	124 9th STREET STATEN ISLAND, NY
JEFFREY VAN BLARCOM	UNKNOWN	240 PROSPECT AVENUE HACKENSACK, NY
VICTOR VERNACI	3/28/71	483 MILL ROAD STATEN ISLAND, NY

UNITED STATES V. DIONISIO, ET AL.

DEFENDANT	DOB	ADDRESS
DOMINICK DIONISIO	1/29/70	42 MANDY COURT STATEN ISLAND, NY
ENRICO LOCASCIO	4/15/70	86 GARRETSON AVENUE STATEN ISLAND, NY
YAKOV SLAVIN	3/19/63	3280 NOSTRAND AVENUE BROOKLYN, NY
JOHN MANION	6/8/48	1227 MAJESTIC DRIVE APOPKA, FL
KENNETH MANDILE	3/15/53	117 EYLANDT STREET STATEN ISLAND, NY
JACK BASILE	2/7/73	1433 73rd STREET BROOKLYN, NY
CHRISTOPHER MORMANDO	3/3/70	16 MANDY COURT STATEN ISLAND, NY
CHRISTOPHER WOLF	10/26/68	INCARCERATED
FRANK RAGUSA	6/6/62	39 STACEY LANE STATEN ISLAND, NY
JOSEPH LANNI	4/15/71	8874 15TH AVENUE BROOKLYN, NY
BRIAN DUFFY	7/13/72	67-01 52nd ROAD MASPETH, NY
GERARD BRUZZESE	1/12/64	1130 69th STREET BROOKLYN, NY
CHARLES DIMAGGIO	3/23/71	1826 74th STREET BROOKLYN, NY
JOHN PUGLIESE	1/12/67	63A AUDREY AVENUE OYSTER BAY, NY
ANTHONY TOLENDINI	4/11/69	2164 62nd STREET BROOKLYN, NY

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MICHAEL CERRATO	11/14/72	29 BAY 22nd STREET BROOKLYN, NY
ALEX LEVIN	1/27/69	2915 W. 5th STREET, APT. 15F BROOKLYN, NY
RUSLAN DZHIKIYA	12/26/69	3096 BRIGHTON 6th STREET BROOKLYN, NY
DENIS YUROFSKY	7/19/78	2318 E. 63rd STREET BROOKLYN, NY
SIMUEL STEVENSON	6/9/67	198 VICTORY BOULEVARD STATEN ISLAND, NY
MICHAEL HOUSTON	4/10/67	1655 FLATBUSH AVENUE BROOKLYN, NY
ALEXANDER MUCHNIK	12/28/75	2630 OCEAN AVENUE BROOKLYN, NY
MYRON LNU	UNKNOWN	UNKNOWN

UNITED STATES V. WOLF, ET AL. 99 CR 139 (S-1)(NG)

DEFENDANT	DOB	ADDRESS
CHRISTOPHER WOLF	10/26/68	INCARCERATED
WILLIAM BATTISTA	5/10/72	351 MARINE AVENUE BROOKLYN, NY
JAIRO BAQUERO	8/19/68	589 JOHNSTON TERRACE BROOKLYN, NY
CHANCE MIGLINO	9/25/70	45 MALLARD AVENUE STATEN ISLAND, NY
JOSEPH DEMARCO	4/3/71	8191 N. UNIVERSITY DRIVE TAMARAC, FL
ADAM EMMINO	3/3/71	443 99th STREET BROOKLYN, NY
PETER LOMBARDO	12/13/72	1258 77TH STREET BROOKLYN, NY
VINCENT LOCOMBO	1/21/76	28 MARINE AVENUE, APT. 1K BROOKLYN, NY
MICHAEL CORULLA	5/1/73	19 WHITE STREET STATEN ISLAND, NY
ROBERT HINES	12/14/68	7303 13th AVENUE BROOKLYN, NY
MARY BAUM	10/12/64	2176 RICHMOND ROAD STATEN ISLAND, NY

U.S. Department of Justice

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New York City Police Department
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March 2, 2000

PRESS RELEASE

19 DEFENDANTS INDICTED IN STOCK FRAUD SCHEME THAT WAS PROTECTED AND PROMOTED BY ORGANIZED CRIME

LORETTA E. LYNCH, United States Attorney for the Eastern District of New York, **LEWIS D. SCHILIRO,** Assistant Director-in-Charge of the Federal Bureau of Investigation in New York, and **HOWARD SAFIR**, Commissioner, New York City Police Department, today announced the indictment of nineteen defendants, including six members and associates of various Organized Crime Families of La Cosa Nostra, who are charged with participating in a large-scale stock fraud and money laundering scheme between 1993 and 1996. Seventeen of the nineteen

defendants are charged with racketeering

The charges in the indictment center on the activities of two brokerage firms with offices in downtown Manhattan White Rock Partners & Co ("White Rock") and State Street Capital Markets Corporation ("State Street").[1] The indictment alleges that the principals of White Rock and State Street, together with other brokers and brokerage firms, planned and carried out a series of fraudulent securities schemes and then laundered tens of millions of dollars of illicit profits

As alleged in the indictment, the schemes were led by the defendants JOHN DOUKAS and WALTER DURCHALTER, together with Gennady Klotsman, Salvatore Lauria and Felix Sater, who collectively controlled White Rock and State Street ("the White Rock and State Street Partners").[2] The White Rock and State Street Partners secretly acquired large blocks of stock and warrants in the following four companies: Country World Casinos, Inc. ("Country World"), which was based in Colorado and was purportedly attempting to develop a casino in Black Hawk, Colorado, Holly Products, Inc. ("Holly"), which was based in Moorestown, New Jersey and was in the business of manufacturing tables and cabinets for the gaming industry and custom-built equipment for hospitals; U.S. Bridge of New York, Inc. ("USBNY"), which was based in Queens, New York and was a subcontractor on public infrastructure projects in the greater New York area; and Cable & Co Worldwide, Inc. ("Cable"), which had offices in New York and New Jersey and designed and imported men's footwear which was sold to department and specialty stores in the United States

The indictment alleges that the White Rock and State Street Partners were able to

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[1]White Rock and State Street ceased operations in late 1996.

[2]Klotsman, Lauria and Sater have previously pleaded guilty to RICO charges in connection with their activities at White Rock and State Street.

acquire secret control of these securities through undisclosed financial arrangements with the following defendants ABRAHAM SALAMAN, a stock promoter who provided the Country World stock; LARRY BERMAN, Holly's chairman and chief executive officer; and JOSEPH POLITO, SR., an associate of the Gambino Organized Crime Family who was the president and principal shareholder of USBNY.

As alleged in the indictment, the White Rock and State Street Partners secretly acquired control of the securities in the name of various nominees including the defendant DANIEL LEV. Most often, the nominees were off-shore companies controlled by the White Rock and State Street Partners. The price of the securities was then artificially inflated through the activities of brokers who fraudulently sold the stock to investors in return for received undisclosed cash payments from the White Rock partners. These brokers included the defendants JACK BASILE, ROCCO BASILE and JOSEPH TEMERINO at White Rock, and ALFRED PALAGONIA and JOHN CIOFFOLETTI, who were brokers at J.W. Barclay & Co., Inc., and D.H. Blair & Co., Inc., respectively.[3] Among the techniques used to artificially inflate and maintain the price of the manipulated securities, the indictment alleges that the defendants: (a) made false and misleading statements to persuade investors to buy and then not to sell the securities; (b) purposely failed to take and execute customer orders to sell the securities; and (c) only executed a sale of a security if the sale could be matched or "crossed" with a corresponding purchase of the same security by another investor.

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[3]JACK BASILE also has securities fraud and money laundering charges pending against him in United States v. Dionisio, et al., 99 CR 589 (EDNY). ROCCO BASILE has securities fraud and money laundering charges pending against him in United States v. Catoggio, 98 CR 1129(S) (SDNY).

The indictment alleges that after the price of the stock was artificially inflated, the defendants sold their secretly held stock for a substantial profit. The proceeds from these illicit sales were then laundered through multiple transfers of funds to off-shore bank accounts by the defendant ALEKS PAUL, who then provided a corresponding amount of cash, less a money laundering fee, to the White Rock and State Street Partners.[4] Profits for other defendants were laundered through different schemes. For example, the indictment alleges that defendants JOSEPH POLITO, SR. and EDMOND NAGEL[5] secretly divided proceeds of approximately $380,000 derived from the sale of USBNY warrants that were deposited in an off-shore nominee's brokerage account controlled by NAGEL.

The indictment further alleges that the White Rock and State Street Partners enlisted the help of individuals affiliated with Organized Crime Families of La Cosa Nostra to protect and promote their criminal activities by resolving disputes and performing other services. Defendant FRANK COPPA, SR. was a captain in the Bonanno Organized Crime Family. Defendant ERNEST MONTEVECCHI was a soldier in the Genovese Organized Crime Family.[6] Defendant DANIEL PERSICO was an associate of the Colombo Organized Crime family. Defendant EUGENE

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[4]PAUL also has securities fraud and money laundering charges pending against him in United States v. Schwartz, et al., 99 CR 372 (EDNY), and United States v. Paul, et al., 99 CR 261 (SDNY).

[5]NAGEL also has bank fraud charges pending against him in United States v. Gangi, et al., 97 CR 1215 (SDNY).

[6]MONTEVECCHI is in custody based on his 1999 conviction in United States v. Gangi, et al., 97 CR 1215 (SDNY).

LOMBARDO was an associate of the Bonanno Organized Crime Family[7] COPPA, MONTEVECCHI, PERSICO and LOMBARDO resolved and attempted to resolve disputes relating to the hiring and retention of brokers, the extortion and attempted extortion of participants in the scheme, and concerted efforts to reduce the price of securities underwritten by White Rock and State Street through short selling. In return for this assistance, COPPA, MONTEVECCHI, PERSICO and LOMBARDO received compensation in the form of securities and cash proceeds from the sale of securities.

The indictment also alleges that, in connection with the USBNY fraud scheme, the defendant LARRY RAY agreed to pay $100,000 to an executive of a bond brokerage firm to insure that USBNY would be granted bonding that would enable it to act as a general contractor on large-scale construction projects. Finally, the indictment alleges that defendants JOSEPH POLITO, SR., USBNY's president and an associate in the Gambino Crime Family, and EDWARD GARAFOLA, a soldier in the Gambino Crime Family, attempted to extort money from Felix Sater and others to recoup this $100,000 cash payment, but that defendant ERNEST MONTEVECCHI intervened on Sater's behalf, causing the extortionate demands to cease.

The charges in the current indictment carry the following maximum sentences: as to each RICO count, 20 years imprisonment, 3 years supervised release, a $250,000 fine (or twice the gross gain or loss) and an order of restitution; as to each money laundering count, 20 years imprisonment, 3 years supervised release, a $250,000 fine (or twice the gross gain or loss) and an order of restitution; as to each substantive securities fraud count, 10 years imprisonment, 3 years

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[7] LOMBARDO is in custody based on his 1999 conviction in United States v. Gangi, et al., 97 CR 1215 (SDNY).

seized it. A recurrent theme in our investigations has been that organized crime goes where the money is. We intend to be there when they get there."

Commissioner **SAFIR** stated: "I am pleased to join with United States Attorney Loretta Lynch, and Assistant Director-in-Charge of the Federal Bureau of Investigation in New York Lewis Schiliro, in announcing the indictment of 19 individuals responsible for a $40 million dollar stock fraud ring. We called this 'Operation Street Cleaner,' because it was designed to fight fraud on Wall Street, but it could just as well been titled 'Goodfellas Meet the Boiler Room.' For those that seek to use these 'pump and dump' schemes to prey on unsuspecting investors, today's indictment should serve as a stark reminder that stock fraud is a serious crime and the law enforcement community is firmly committed to shutting down these and other illicit operations used to support organized crime."

Those defendants arrested in New York will be arraigned today by Magistrate Judge Joan M. Azrack at the United States Courthouse in Brooklyn.

The case is being prosecuted by Assistant U.S. Attorneys Jonathan S. Sack, Eric Corngold and Richard Molot.

The Defendants

FRANK COPPA, SR.
8 Brittany Ct.
Manalapan, NJ
DOB: 9/11/41
Counts: 1, 2, 3, 4, 13, 14, 15, 16

ERNEST MONTEVECCHI,
a/k/a "Butch"
Incarcerated
DOB: 6/18/45
Counts: 2, 13, 14

DANIEL PERSICO
6615 Wallaston, Ct.
Brooklyn, NY
DOB: 4/9/62
Counts: 2, 13, 14

JACK BASILE
1444 73d Street
Brooklyn, NY
DOB: 2/7/73
Counts: 2, 5, 6, 7, 8

ROCCO BASILE
150 Bay 8th Street
Brooklyn, NY
DOB: 2/21/68
Counts: 2, 5, 6, 7, 8

LARRY BERMAN
450 Merion Rd.
Merion Station, PA
DOB: 11/30/34
Counts: 1, 2, 3, 4, 5, 6, 7, 8

JOHN CIOFFOLETTI
27 Seagull Lane
Lincroft, NJ
DOB: 11/20/69
Counts: 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 15, 16, 17, 18

JOHN DOUKAS
35 Briar Ct.
Cross River, NY
DOB: 2/19/48
Counts: 1, 2, 5, 6, 7, 8, 9, 10, 11, 12, 15, 16, 17, 18

WALTER DURCHALTER,
a/k/a "Dutch"
63-57 84th Street
Middle Village, NY
DOB: 9/30/65
Counts: 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12

EDWARD GARAFOLA
143 Lander Ave.
Staten Island, NY
DOB: 3/25/38
Counts: 19, 20

DANIEL LEV
149-05 Rockaway Beach Blvd.
Neponsit, NY
DOB: 7/12/66
Counts: 1, 2, 9, 10, 11, 12

EUGENE LOMBARDO
Incarcerated
DOB: 4/20/52
Counts: 1, 2, 3, 4, 9, 10, 11, 12

EDMOND NAGEL
New York, NY
DOB: 11/1/40
Counts: 1, 2, 9, 10, 11, 12

ALFRED PALAGONIA
18 Eastgate Rd.
Port Washington, NY
DOB: 12/31/66
Counts: 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 15, 16, 17, 18

ALEKS PAUL
4 Ridgeway Drive
Kings Point, NY
DOB: 11/7/57
Counts: 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12

JOSEPH POLITO, SR.
Boca Raton, Florida
DOB: 5/15/34
Counts: 1, 2, 9, 10, 11, 12, 19, 20

LAWRENCE RAY
2 Cedar Ridge Lane
Warren, NJ
DOB: 11/16/59
Counts: 9, 10

ABRAHAM SALAMAN
9728 Wynmill Rd.
Philadelphia, Pa.
DOB: 10/29/35
Counts: 2, 3, 4

GIUSEPPE TEMPERINO,
a/k/a "Joseph Temperino"
263 Avenue S
Brooklyn, NY
DOB: 8/27/74
Counts: 2, 5, 6, 7, 8

United States Attorney
Southern District of New York

FOR IMMEDIATE RELEASE
JUNE 14, 2000

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PRESS RELEASE

MARY JO WHITE, the United States Attorney for the Southern District of New York and BARRY W. MAWN, the Assistant Director in Charge of the New York Office of the Federal Bureau Of Investigation ("FBI"), joined by RICHARD WALKER, Director of Enforcement of the United States Securities and Exchange Commission ("SEC"), and MARY L. SHAPIRO, President of NASD Regulation, announced today that 120 defendants, including members and associates of the five Organized Crime Families of La Cosa Nostra

in the New York City area, have been charged with securities fraud and related crimes. Sixteen Indictments and seven criminal Complaints unsealed today in Manhattan federal court allege fraud in connection with the publicly traded securities of 19 companies and the private placement of securities of 16 other companies.

Included among the defendants are 10 alleged members and associates of organized crime; a former New York Police Department detective; 57 licensed and unlicensed stock brokers; three recruiters of corrupt brokers; 12 stock promoters; 30 officers, directors or other "insiders" of the companies issuing the securities involved in the frauds; two accountants; an attorney; an investment adviser; and a hedge fund manager. According to the charges, 21 broker-dealers or other financial adviser firms were either involved in the frauds, or employed stock brokers or other persons who were involved in the fraud. The various schemes resulted in total losses of more than approximately $50 million, and many tens of millions more would have resulted had the schemes been completed.

According to Ms. WHITE and Mr. MAWN, this is the largest number of defendants ever arrested at one time on securities fraud-related charges, and one of the largest number ever arrested in a criminal case of any kind. In coordination with today's arrests, search warrants were executed at four locations in New York, one in Dallas, Texas, and one in Salt Lake City, Utah.

Twenty-one defendants are charged with participating in a RICO Enterprise consisting of members and associates of the Bonanno and Colombo Organized Crime Families of La Cosa Nostra in the New York City area, that allegedly perpetrated massive securities fraud over a five-year period by forging corrupt alliances with members and associates of the remaining three New York City Organized Crime Families; controlling and infiltrating broker-dealers; conspiring with issuers of securities and individual stock brokers; scheming to defraud union pension plans; and employing tactics of violence, including threats, extortion, physical intimidation, and the solicitation of murder to further the illegal goals of the RICO Enterprise. The schemers used traditional boiler-room operations and current Internet techniques to carry out their alleged crimes.

The racketeering defendants include, among others: ROBERT A. LINO, a/k/a "Little Robert," an alleged capo in the Bonanno Crime Family; FRANK A. PERSICO, an alleged associate of the Colombo Crime Family, and a registered stock broker who controlled crews of brokers at various brokerage firms, including First Liberty Investment Group, Inc., William Scott & Company, Inc., and Bryn Mawr Investment Group; ANTHONY P. STROPOLI, an alleged soldier in the Colombo Crime Family who controlled crews of stock brokers; STEPHEN E. GARDELL, who is alleged to have corruptly exploited his positions as a New York City Police Department Detective and Treasurer of the Detectives' Endowment Association ("DEA"); GENE PHILLIPS, who controlled Basic Capital Management, the investment

adviser to American Realty Trust, a New York Stock Exchange-listed real estate investment trust, or REIT; and WILLIAM P. STEPHENS, the Chief Investment Strategist of Husic Capital Management, a San Francisco-based investment adviser, who agreed to manage up to $300 million in union pension funds knowing that a portion would be invested in corrupt deals for the purpose of funding kickbacks to members of the RICO Enterprise and corrupt union officials.

The RICO Enterprise is alleged to have engineered manipulation schemes in eight publicly traded securities and to have defrauded investors in connection with three private placements of securities, including one by Ranch*1 Inc., a company that operates fast food restaurants in the New York City area and elsewhere. Two officers of Ranch*1, SEBASTIAN RAMETTA and JAMES F. CHICKARA, have been named as defendants in the RICO charges and are alleged to be associates of the Colombo Crime Family.

In addition to the racketeering charges, the other Indictments and Complaints unsealed today charge a wide array of stock market schemes designed to fleece the investing public. Sales of stock in private placements are alleged to have been fraudulently rigged for the benefit of insiders and corrupt brokers. The Internet was allegedly used to further the schemes through the fraudulent promotion of stocks on Internet websites, or the use of companies that were touted as Internet or "dot.com" companies in order to induce investors to capitalize on the Internet boom.

Today's charges are the result of a highly successful, one-year undercover operation conducted by the FBI's New York Office, in coordination with the SEC and with assistance provided by NASD Regulation, Inc. The undercover investigation involved, among other things, surveillance, the use of undercover purchases of securities, the use of a series of cooperating witnesses who posed as willing participants in ongoing criminal schemes, and the installation of court-authorized eavesdropping devices in the office of DMN Capital Investments, Inc. ("DMN Capital"), a financial adviser firm that held itself out as providing investment banking and stock promotion services. Pursuant to court order, the FBI recorded approximately 1000 hours of conversations occurring in DMN Capital's office between December 1, 1999 and May 4, 2000.

Ms. WHITE stated:

> Today's charges result primarily from the FBI's successful infiltration of a company that served as investment banker to the crooked and the corrupt. By offering its services to anyone and any deal, as long as it was illicit, the company attracted allegedly mobbed-up broker-dealers, top-shelf investment advisers, unscrupulous issuers, unethical lawyers and accountants, and microcap manipulators - a virtual Who's Who of securities violators. Their tentacles of fraud reached into every corner of the public and private securities markets, and they preyed on their victims using both traditional boiler-room tactics and contemporary Internet-based manipulations. As today's charges show, fraud in the markets will not be tolerated, no matter how big, how organized, or how creative.

Mr. MAWN stated:

> The FBI investigation code named "Uptick" has uncovered a laundry list of stock manipulation schemes by which the defendant brokers took their victims to the cleaners. This investigation uncovered once again La Cosa Nostra's efforts to

infiltrate the securities markets. No matter what market the mob tries to infiltrate, from the fish market to the stock market, the methods it uses are always the same: violence and the threat of violence. We will continue to investigate securities fraud schemes whether they be the work of typical white collar criminals or of organized crime.

Mr. WALKER stated:

The securities fraud involved in today's actions is among the most egregious witnessed in recent years. These manipulations of numerous microcap stocks were designed for the sole purpose of stealing investors' hard-earned dollars. The prosecutions announced today rid the vital market for low-priced securities of unscrupulous operators and reaffirm regulators' commitment to keeping this market safe and fair.

Ms. SHAPIRO stated:

Today's actions by United States Attorney Mary Jo White again demonstrate her commitment to help rid securities markets of manipulative and fraudulent schemes. NASD Regulation previously brought actions against a number of firms and individuals named in the Indictments unsealed today and will continue to work closely with the United States Attorney's Office and other law enforcement and regulatory agencies to insure investor confidence and the integrity of our markets.

Certain of the charges are outlined below.

Racketeering

In United States v. Lino, et al., 00 Cr. 632, 21 defendants are charged with being members and associates of a RICO Enterprise consisting of DMN Capital and a "joint venture" among members and associates of the Bonanno and Colombo Crime Families, with the assistance of associates of the other three New York City crime families, as well as others. In addition to LINO, PERSICO, STROPOLI, GARDELL, RAMETTA, CHICKARA, STEPHENS, and PHILLIPS, the other alleged members of the RICO enterprise include: JAMES S.

LABATE, a/k/a "Jimmy"; SALVATORE R. PIAZZA, a/k/a "Sal"; CARY F. CIMINO; RALPH DEMATTEO, a/k/a "Ralphie"; ROBERT P. GALLO, a/k/a "Bobby"; MICHAEL GRECO; JOHN M. BLACK, Jr.; ANGELO CALVELLO, a/k/a "Tony"; JOSEPH A. MANN, a/k/a "Andy"; GLENN B. LAKEN; A. CAL ROSSI; VINCENT G. LANGELLA, a/k/a "Vinny"; WILLIAM F. PALLA; and TODD NEJAIME. The Lino Indictment charges the defendants with various crimes, including those described below:

1. Manipulation of Publicly Traded Securities: Between 1995 and 1999, members of the RICO Enterprise fraudulently obtained and controlled large blocks of free or substantially-discounted, publicly-traded securities in violation of various SEC rules and regulations. These securities included those issued by: (1) Spaceplex Amusement Centers International Ltd., which operated amusement parks and was located in Great Neck, New York; (2) Reclaim, Inc., which was in the business of recycling roofing shingles and was located in Tampa, Florida; (3) Beachport Entertainment Corp., which was in the business of producing ice skating entertainment and was located in Los Angeles, California; (4) International Nursing Services, Inc., which was in the business of in-home nursing care and was located in Denver, Colorado; (5) Leasing Edge Corporation, which was in the computer leasing business; (6) Globus Int'l Resources Corp., an import-export company; (7) Innovative Medical Services, a manufacturer of waste purification systems; and (8) Accessible Software, Inc., a software developer.

The RICO Enterprise is alleged to have secretly controlled or infiltrated various New York City-area brokerage firms, including Monitor Investment Group, Inc., Meyers Pollock and Robbins, First Liberty Investment Group, Inc., William Scott & Company, and Atlantic General Financial Group. The RICO Enterprise then fraudulently engaged in prearranged trades, paid secret bribes to corrupt stock brokers, and used "no net sale" and other "boiler room" tactics, among other devices, to create artificial retail demand for these securities, and then sold their holdings into that inflated demand at considerable profit. Members of the RICO Enterprise, in order to enforce discipline among the brokers allegedly involved in these schemes, and to punish those who reneged on their agreements to sell stock in return for bribes, subjected brokers to beatings, intimidation, and threats. To aid in the fraudulent schemes, CARY F. CIMINO, a New York-based stock promoter, arranged for secret bribes to be paid to corrupt brokers and, in 1999, CIMINO is alleged to have solicited the murder of a person he believed to be a cooperating witness.

2. Union Pension Funds Fraud and Kickback Schemes: From late 1999 to the present, the RICO Enterprise allegedly sought to defraud union pension funds by employing corrupt securities industry professionals to manage union pension funds, and then, with the knowledge and consent of those professionals, structuring investments for those funds in a manner that allowed for a secret diversion of a portion of the funds to members of the RICO

Enterprise and to corrupt union officials. One such alleged fraudulent investment was a preferred stock offering of American Realty Trust, a NYSE-listed REIT that trades under the ticker symbol "ARB." The RICO Enterprise allegedly arranged this corrupt deal through GENE PHILLIPS, who controlled Basic Capital Management, Inc., a Dallas, Texas-based financial adviser firm that served as adviser to American Realty Trust, and A. CAL ROSSI, the Managing Director of Capital Markets for Basic Capital. According to the charges, union pension fund assets would be invested in the offering, and $2.0 million of every $10 million invested would be "kicked back" to the RICO Enterprise and corrupt union officials. In order to give an investment in ARB Series J preferred stock an air of legitimacy, and to convince honest union officials to permit such an investment, the Enterprise recruited an allegedly corrupt money manager, WILLIAM P. STEPHENS, the Chief Investment Officer of Husic Capital Management, a San Francisco-based investment adviser, who allegedly agreed to manage up to $300 million in union pension funds knowing that a portion would be invested in this corrupt deal for the purpose of funding kickbacks to members of the RICO Enterprise and corrupt union officials.

A second allegedly fraudulent investment deal designed to defraud union pension funds involved TradeVentureFund, a hedge fund that claimed to have a successful proprietary trading strategy, and whose principal manager was GLENN B. LAKEN. Here, kickbacks to the RICO Enterprise and corrupt union officials would allegedly be

funded through the payment of excessive trading commissions and LAKEN's plan to invest the union pension funds in high-risk investments.

The pension funds targeted in these allegedly corrupt schemes include: the Production Workers Local 400, which is alleged to be influenced by the Colombo Crime Family; the International Union of Operating Engineers Local 137; and the Detectives' Endowment Association ("DEA"), which serves NYPD detectives. Integral to the success of the alleged schemes involving DEA and Local 400 were STEPHEN E. GARDELL and FRANK A. PERSICO, a/k/a "Frankie," the latter of whom was an alleged associate of the Columbo Crime Family who served as the Treasurer of Production Workers Local 400, each of whom is alleged to have agreed to accept illegal kickbacks to corruptly influence decisions at their respective unions. GARDELL is also alleged to have: (a) leaked confidential law enforcement information concerning organized crime investigations to members and associates of organized crime; (b) assisted in securing firearm "carry" permits for members of organized crime; (c) influenced the outcome of an NYPD investigation into the activities of a member of the RICO Enterprise; and (d) provided New York City law enforcement parking permits to members of organized crime. In return, GARDELL is alleged to have received, among other things, cash and property from organized crime figures, including $8,000 toward the building of a swimming pool at his residence, free and substantially-discounted rooms and meals at casinos in Las Vegas and Atlantic

City, and a fur coat.

3. Private Placement Fraud: From approximately October 1999 to the June 2000, the RICO Enterprise allegedly sought to defraud investors in the private placement of securities by arranging for the payment of secret exorbitant sales commissions to brokers of up to 50 percent of the proceeds obtained from investors. These fraudulent private placements allegedly included stock of: (a) Ranch*1, a grilled chicken sandwich fast-food chain of restaurants operating throughout the New York City area and elsewhere; (b) World Gourmet Soups, Inc, d/b/a "The Manhattan Soup Man," a company that operates and franchises fast food restaurants and kiosks and sells prepared soups to the restaurant industry;[1] and (c) Jackpot Entertainment Magazine, Inc., a Brooklyn-based company in the business of publishing a magazine about the casino industry. The defendants charged in this scheme include SEBASTIAN RAMETTA, a/k/a "Sebbie," the President and Chief Executive Officer of Ranch*1, and JAMES F. CHICKARA, the Vice-Chairman of Ranch*1, both of whom allegedly are associates of the Colombo Crime Family.[2]

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[1] In a Complaint unsealed today, United States v. LaBarbara, 00 Mag. 1121, Stephen LaBarbera, a stock broker at The Agean Group, a New Jersey broker-dealer, is alleged to have received, from November 1999 to January 2000, secret undisclosed commissions in connection with his sales of stock in the private placement of World Gourmet Soups, Inc.

[2] In another Indictment unsealed today, United States v. Trippe, et al., 00 Cr. 585, six other defendants were charged with securities fraud in connection with two private placement offerings by Jackpot Entertainment. Those six defendants are: EDWARD TRIPPE, Jackpot's Chief Financial Officer and Secretary;

Indictments and Complaints
Charging Internet-Related Fraud

The Indictments and Complaints unsealed today allege various frauds involving the use of Internet-related companies to commit fraud, or the use of the Internet to promote the securities of other companies whose stock was being manipulated. All of these cases arise out of the undercover investigation because the perpetrators sought to use DMN Capital in their illegal schemes.

1. WAMEX Holdings, Inc.: WAMEX Holdings Inc. is a Brooklyn-based corporation purportedly in the business of developing an alternative trading system ("ATS") for securities, and whose common stock trades on the OTC Bulletin Board. In United States v. Cushing, et al., 00 Mag. 1118, the three defendants charged are MITCHELL CUSHING, WAMEX's Chief Executive Officer; RUSSELL CHIMENTI, WAMEX's Chief Administrative Officer; and ROGER DETRANO, a New York-based stock promoter, were charged with conspiracy to commit securities fraud from December 1999 to June 2000. According to the Complaint, the scheme involved the issuance of false press

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BRUCE BECKER, Jackpot's President and Publisher; ANDREW ADAMS, Jackpot's Vice President and Chief Executive Officer; SAMUEL WARD, a public accountant; BRYAN MCGUIRE, a registered representative; and PATRICIA OPPITO, a registered representative employed by Wolff Investment Group, Inc. The Indictment alleges that the defendants paid secret undisclosed compensation equal to 50 percent of the funds raised to brokers who sold Jackpot private placement stock to public investors. The Indictment further alleges that WARD falsified Jackpot's financial statements by concealing the secret commissions, and by issuing unqualified audit opinions that falsely certified that he had examined Jackpot's financial statements in accordance with generally accepted auditing standards.

releases stating that ATS would be available by July 4, 2000, misrepresentations in SEC filings regarding the source and nature of funding that WAMEX had obtained, and the payment of secret exorbitant commissions to brokers who sold WAMEX stock to public customers.

The price of WAMEX stock increased from approximately $1.12 per share on December 9, 1999, to approximately $19.50 per share on February 28, 2000. As of June 12, 2000, WAMEX had a market capitalization of over $184 million. In connection with today's actions, the SEC imposed a trading halt on WAMEX stock.

2. E-Pawn.com: E-Pawn.com is a Florida-based company that describes itself as "a multifaceted Internet portal, website designer and e-commerce software developer," and whose stock trades on the OTC Bulletin Board. In United States v. Greyling, et al., 00 Cr. 631, three defendants were charged with securities fraud in connection with an alleged scheme, from January 2000 to June 2000, to pay 1.0 million shares of E-Pawn to be used to bribe brokers to create retail demand for E-Pawn stock, and to use Internet sites and bulk E-Mail to tout E-Pawn to the public. Charged in this scheme are LESLIE GREYLING, an alleged undisclosed principal of E-Pawn; ELI LIEBOWITZ, the President, Chief Financial Officer and a Director of E-Pawn; and TINA ALEXANDER, a Texas stock promoter. As of June 12, 2000, E-Pawn had a market capitalization of approximately $198 million. In connection with today's actions, the SEC imposed a trading halt on E-Pawn stock.

3. FinancialWeb.com: FinancialWeb.com ("FWEB") is a Florida-based company purportedly in the business of creating and operating investment-related Internet services, whose stock trades on the OTC Bulletin Board. In United States v. Laken, et al., 00 Cr. 651, it is alleged that, from February 2000 to June 2000, GLENN B. LAKEN, a hedge fund manager and commodities trader on the Chicago Mercantile Exchange, held a large position in FWEB stock, and enlisted others to fraudulently inflate the price of FWEB stock, and to conceal his identity as the seller. To effect this scheme, LAKEN employed the services of DAVID W. BRUNO and ADAM KRIFTCHER, who allegedly controlled a number of Internet websites, including stockregister.com; bullstrategies.com; wallstreetmarquee.com; atthebell.com; and stockplayground.com, which they allegedly used to conduct coordinated Internet promotions of the stock of publicly-traded companies. Also allegedly involved was MICHAEL PORRICELLI, President of Core Financial, LLC, who controlled a number of Internet websites that he allegedly used to conduct coordinated promotions of the stock of publicly-traded companies. These websites included otcbbstockwatch.com; redalert.com; subway.com; americananalyst.com; powerstocks.com and fortuneinvestments.com. LAKEN also allegedly agreed to use the services of LIONEL REIFLER, President of Fortune Investments, Inc., who allegedly offered a fraudulent newsletter program used to generate high trading volume in OTC securities at inflated prices. According to the Indictment, it was agreed that BRUNO, KRIFTCHER

and PORRICELLI would feature FWEB on websites that they controlled, would promote FWEB by sending bulk E-mails to their website subscribers, and that BRUNO and KRIFTCHER would prepare and post on their websites promotional materials describing FWEB's business and its common stock. LAKEN allegedly agreed to pay BRUNO, KRIFTCHER, REIFLER, and PORRICELLI for their promotional efforts with FWEB stock, and to conceal that fact, as well as LAKEN's involvement in those efforts. Also named in the Indictment is PETER J. WORRELL, a stock broker at and principal of Royal Hutton Securities Corp., who is charged with bribing brokers at Royal Hutton to create retail demand for FWEB stock.

4. SearchHispanic.com and GTrade Network, Inc: SearchHispanic.com is a Plainview, New York-based company engaged in creating and maintaining an Internet website of interest to persons of Hispanic descent. GTrade Network, Inc. ("GTrade") is a Great River, New York-based company that held itself out as an incubator of Internet-related and e-commerce businesses. GTrade common stock trades on the OTC Bulletin Board, and SearchHispanic.com has common stock that is issued, but has not publicly traded. In United States v. Downing, et al., 00 Cr. 555, three persons were charged with a fraudulent scheme, from March 2000 to June 2000, in which SearchHispanic.com would go public by "reverse merging" into GTrade, a publicly-traded company, and then the defendants allegedly would artificially inflate the price of the common stock of the merged entity. According to the

Indictment, JAMES DOWNING, the Chief Executive Officer and controlling shareholder of SearchHispanic.com, met with alleged members and associates of organized crime, including SALVATORE R. PIAZZA, a/k/a "Sal," and agreed that to effect the scheme, approximately 45 percent of the stock in the post-merger entity would be deposited into secret offshore nominee accounts that DOWNING would maintain an interest in, and that he would use to fund the payment of secret bribes to brokers who would generate trading volume in SearchHispanic.com stock. DOWNING would also allegedly sell his personal holdings of the stock to enrich himself and others. As part of the scheme, SAMUEL WARD and DANIEL DRUCKER, both certified public accountants, allegedly agreed to falsify the financial statements of SearchHispanic.com and GTrade, and to issue unqualified audit opinions certifying that the financial statements of the companies were accurate.

5. Cybersentry, Inc.: Cybersentry, Inc. was a Florida-based communications software company that specialized in facilitating secure communications on the Internet. Cybersentry common stock previously traded on the OTC Bulletin Board, and in May 2000 commenced trading on the American Stock Exchange. Two Indictments charging fraud in connection with Cybersentry were unsealed today -- United States v. Wager, et al., 00 Cr. 629, and United States v. Brigandi, et al., 00 Cr. 630. According to the Indictments, NEIL WAGER, an individual residing in Boca Raton, Florida, and BRUCE BRIGANDI, an individual residing in Roslyn Heights, New York, each

allegedly acquired a large block of Cybersentry common stock. According to the Wager Indictment, shortly after acquiring the shares, WAGER agreed to pay undisclosed bribes to KARL FREDERICK GRAFF, a stock broker employed by Equitrade Securities Corp., in exchange for efforts by GRAFF to sell WAGER's stock to GRAFF's retail clients. According to the Brigandi Indictment, shortly after acquiring his shares, BRIGANDI participated in an illegal scheme in which he agreed to pay bribes to brokers in exchange for their efforts in generating retail demand for Cybersentry common stock. It is alleged that these frauds occurred from March 2000 to June 2000.

6. Bookdigital.com: Bookdigital.com was a New York-based corporation that held itself out as a development-stage company in the business of creating and operating reference sites on the Internet. In a Complaint captioned United States v. Vahab, 00 Mag. 1120, RAY VAHAB, the Chairman of the Board and Chief Executive Officer of Bookdigital.com, allegedly controlled a vast majority of Bookdigital.com stock, and was also the owner of First Madison Securities, a New York-based broker-dealer. The Complaint alleges that from April 2000 to June 2000, VAHAB embarked on a scheme in which he would first raise capital by paying bribes to brokers to sell Bookdigital.com private placement stock, and then manipulate the publicly-available stock by "reverse mergering" Bookdigital.com into a publicly-traded shell corporation.

7-9. Exchange Online, Inc., Amerivest.Online Inc., and Franklin Services Corp.: Each of these three companies purported to be involved in Internet-related businesses, and were allegedly the subject of sham private placement offerings as set forth below in United States v. Tavolacci, et al., 00 Cr. 554.

Fraud and Manipulation
Of Publicly Traded Securities

Certain of the Indictments and Complaints unsealed today charge fraud in connection with the markets for publicly-traded securities.

1. In United States v. Dacunto, et al., 00 Cr. 620, 26 defendants were charged with manipulation of four of the publicly-traded securities identified in the Lino Indictment as being the subject of manipulation by the RICO Enterprise -- Spaceplex, Reclaim, Beachport, and International Nursing. The defendants named in the Dacunto Indictment, which covers the period from December 1994 to late 1996, include persons who served as brokers at Monitor Investment Group, the broker-dealer controlled by the RICO Enterprise that was used to manipulate the markets in the above-mentioned publicly-traded securities. The defendants named in the Dacunto Indictment include the following persons, who were either promoters, managers, or licensed or unlicensed brokers: ROBERT J. DACUNTO; MICHAEL P. DACUNTO; JOSEPH P. MEDURI; VINCENT A. PADULO; JR.; VITO G. PADULO; JOHN BRUZZESE; SALVATORE F. RUGGIERO; PATRICK GIGLIO, a/k/a "Patty"; CHESTER L. CHICOSKY; LAWRENCE M.

CHOINIERE; WILLIAM P. BURKE; KEVIN RADIGAN; GEORGE P. BISNOFF; DAMIEN R. DOUGLAS; CRAIG P. MCGUINN, II; MARC L. WEISSMAN; MARK M. DANIELI; IRVING STITSKY; PAUL L. BURTON; KENNETH J. FUINA; MARC I. BURTON; EMMANUEL G. GENNUSO; and FACUNDO PONCE, a/k/a "Frank"

2. United States v. Wolfson, et al., 00 Cr. 628, charges seven persons in a scheme, occurring from 1988 to May 2000, to manipulate the stock of five companies whose securities traded on the OTC Bulletin Board or the NASDAQ Small-Cap Market. They include: (a) ATR Industries, Inc., a Ft. Lauderdale company in the business of operating home cleaning services; (b) Rollerball International, Inc., a Delaware corporation that manufactured inline roller skates; (c) Learners World, Inc., a New York corporation that operated learning and day care centers for children; (d) Healthwatch, Inc., a Minnesota corporation that manufactured medical products; and (e) Hytk Industries, Inc., a Nevada corporation that produced and transported natural gas.

The defendants charged in this case are: ALLEN WOLFSON, a Salt Lake City-based stock promoter who was a consultant to Cyberamerica Corp., a company that purported to be in the business of providing financial consulting services to distressed public companies; MICHAEL GRECCO, a New York-based stock promoter; JOHN MICHAEL BLACK, a stock broker and principal of Grady and Hatch and Co., a Manhattan broker-dealer; SPIRO LAZARETOS, a broker who worked at Caribbean Securities, a New York broker-dealer, and at Grady and Hatch; ROBERT BALSAMO, a stock promoter who worked at Wolff

Investment Group and Delta Asset Management, both New York broker-dealers; VLADIMIR CARVALLO, a stock broker affiliated with Morgan Grant Capital Corp., a New York broker-dealer, and with Delta Asset Management; and KONSTANTINOS DINO SONITIS, a stockbroker at Bell Investment Group, a New York-based broker-dealer.

According to the Indictment, WOLFSON allegedly received large amounts of stock in the companies, either free-of-charge or at substantial discounts, and then allegedly agreed to pay GRECCO a bribe equal to between 40 and 70 percent of the value of retail sales of WOLFSON's stock as generated by stock brokers under GRECCO's control. To effect the scheme, GRECCO allegedly recruited the other defendants to sell WOLFSON's stock in exchange for bribes. WOLFSON also allegedly instructed his coconspirators that his stock be "crossed with," or purchased by, the retail customers, which he accomplished by directing the brokers to direct their trades to certain market makers that were in league with WOLFSON.

3. United States v. Gasparik, et al., 00 Cr. 650, charges fraud, from April 2000 to June 2000, in connection with the stock of Harbour Intermodal Ltd., a development-stage company that planned to provide local freight shipping among rail, truck and water transportation companies in the New York harbor area, and that traded on the OTC Bulletin Board. The Indictment charges that, as of April 2000, MICHAEL GASPARIK, Harbour Intermodal's Chief Executive and Chairman of the Board, owned 87 percent of Harbour's common stock. GASPARIK allegedly sought the assistance

of Michael Grecco, a stock promoter, and agreed to give Grecco large amounts of Harbour stock as substantial discounts, if Grecco and others would inflate the share price of Harbour stock through fraudulent Internet promotions and by paying bribes to brokers in return for selling Harbour stock to their clients. In order to facilitate the scheme, David W. Bruno and Adam Kriftcher allegedly agreed to feature Harbour on Internet websites under their common control in exchange for payments of Harbour stock. In addition, GASPARIK allegedly recruited ROGER FIDLER, an attorney, to prepare SEC filings that were false because, among other things, they allegedly concealed the agreement to pay bribes to brokers in return for purchases by their customers of Harbour stock, and allegedly concealed GASPARIK's control of a trust used to conceal the payment to Greco of large amounts of Harbour stock.

4. United States v. Lugo, 00 Mag. 1119, is a Complaint charging fraud, from May 1999 to June 1999, in connection with the securities issued by Premier Classic Art, Inc. ("PART"), and which traded on the OTC Bulletin Board. JOSEPH LUGO, the defendant, was in control of PART's management, and controlled a large block of its stock. According to the Complaint, LUGO allegedly met with members and associates of organized crime, including Robert Lino, a/k/a "Little Robert," and devised a scheme in which he would obtain a falsely inflated, $10 million appraisal for certain assets, i.e., original animation drawings, and then "reverse merge" a company holding those assets into PART, a large amount of the

stock of which was controlled by LUGO. In fact, LUGO allegedly did conduct a "reverse merger," and obtained the false appraisal which valued the assets at $12 million to $20 million.

Fraud In The Sale
Of Privately Placed Securities

Other of the Indictments and Complaints unsealed today charge fraud in connection with the private placement of securities. Many of these schemes involve "boiler room" sales tactics, and the payment of secret extraordinary commissions to brokers in exchange for their efforts in selling the stock, which commissions are concealed from the investors.

1. United States v. Tavolacci, et al., 00 Cr. 554, charges 18 defendants in connection with five fraudulent private placement stock offerings that extended from April 1997 to May 1999. According to the Indictment, groups of non-registered stock brokers, or "cold callers," using scripts replete with false and fraudulent information, made unsolicited "cold" calls to potential investors to induce them to invest in the sham private placements. In selling the stock, the cold callers allegedly: (a) concealed the fact that they were receiving extraordinary compensation equal to approximately thirty percent of the value of the funds they raised from investors; (b) used false names when speaking to investors; (c) misrepresented that investor funds would be used by the issuer for business purposes, when in fact more than 50 percent of the money raised in each private placement was used to pay brokers and

unlawfully enrich the principals of the issuer; (d) misrepresented that each issuer would conduct an initial public offering ("IPO") of its common stock shortly after the investors' purchase of common stock in the private placement; and (e) misrepresented that the issuers were successful businesses.

The issuers involved in this alleged scheme were the following: (a) First Fidelity Financial Co., purportedly an investment banking firm in Manhattan; (b) Exchange.Online, purportedly an online financial and business "cybermall" located in Delaware; (c) First Fidelity Equities, purportedly a Manhattan brokerage firm; (d) Amerivest.Online, purportedly a Manhattan business that designed customer web sites; and (e) First Commerce Corp., purportedly a Manhattan investment adviser firm. Among the defendants indicted were: SALVATORE TAVOLACCI, executive vice-president of First Fidelity Financial Corp. and First Fidelity Investment Management ("FFIM"); KARL DONOVAN, Vice President of Exchange Online; FREDERICK WALL, President, Treasurer and Secretary of First Fidelity Equities; DEREK SHAPIRO, a/k/a "David Shapiro," an officer of First Fidelity Equities; AARON SANDSTROM, Vice-President of Amerivest; and DONALD BROOKS, president and secretary of First Commerce. Also indicted were 12 persons who worked as cold-callers.

2. United States v. Torregrossa, et al., 00 Cr. 648, charges two defendants in connection with a fraudulent private placement stock offering by Franklin Services Corp. which held itself out as

an investment banking, real estate, and media firm that intended to service clients via the World Wide Web. According to the Indictment, between February 1999 through June 2000, MARK TORREGROSSA, President and Chief Executive Officer of Franklin Services, and JAMES MONTES, an unlicensed broker, fraudulently sold Franklin Services stock by fraudulent means, including: (a) paying secret extraordinary compensation to brokers to sell the stock, while telling investors that their funds would be used for business purposes; (b) representing that a Franklin Services IPO would occur shortly after the investors purchased private placement stock; and (c) representing that Franklin Services would soon be acquired by Amazon.com, and was planning to acquire Circuit City and Toys R Us.

3. United States v. Zavats, et al., 00 Cr. 247, charges eight defendants in connection with an alleged fraudulent private placement stock offerings that extended over a two-year period from 1996 to 1998 and involved three companies: (i) Traveler's Infocenter, which represented itself to be a New York, development-stage company involved in providing travel-related information; (ii) Diagnostic Professional Imaging Services, which represented itself to be a Brooklyn-based, development-stage company that planned to provide MRI services; and (iii) Nationwide, which represented itself to be a Brooklyn-based, development stage medical supply company. The scheme to defraud in connection with all three private placements involved false representations to investors that the companies had promising business prospects, that

all investor funds would be used for business purposes, and the use of phony names by brokers selling the private placement stock.

Among the defendants indicted were the following: MARK HIMMELBERGER, Traveler's Infocenter's President and Treasurer, JUSTIN MARVUL, a/k/a "Eric Feldman," Traveler's Infocenter's Vice President and Secretary and the Treasurer of Diagnostic; MARAT ZAYATS; the Vice President and Secretary of Nationwide who sold Traveler's securities; GREGORY LEVIN, the President and Treasurer of Nationwide who sold Traveler's securities; MICHAEL DANILOVICH, Diagnostic's President and Secretary; HARVEY OSHER, a/k/a "Harvey Cohen"; and JAMES GABERKORN and VADIM SHAPIRO, registered representatives who worked at Hornblower and Weeks, a broker-dealer, and sold Diagnostic private placement stock.

4. United States v. Gladstone, et al., 00 Cr. 652, charges four defendants with fraud in connection with the private placement of stock issued by Ivy Entertainment.com, Inc., a marketing and distribution company specializing in the entertainment, hospitality, financial and technology businesses. The defendants include: RICHARD GLADSTONE, Ivy's President; HOWARD HELFANT, Ivy's Executive Vice President; GUS GELMAN, who recruited brokers to sell Ivy securities, and ROBERT WADE, who sold Ivy securities. According to the Indictment, from May 1999 to October 1999, the defendants, in order to sell Ivy securities, agreed to pay exorbitant sales commissions to brokers, and to conceal those payments from investors.

5. United States v. Amato, et al., 00 Mag 1109, charges three defendants with securities fraud, from 1998 to June 2000, in connection with the private placement of stock of Future Fitness, Ltd., a company that operated health clubs in the New York City area. The defendants include: RENE ARMANDO DEPERALTA, JOHN AMATO, a/k/a "Flames," the Chief Operating Officer of Future Fitness, and FRANK ROTELLA, the Chief Executive Officer of Future Fitness. The scheme allegedly involved the payment of secret bribes equal to approximately 40 percent of the value of Future Fitness common stock in return for brokers selling the stock to unsuspecting investors, and falsely telling investors that the proceeds of the private placement would be used in Future Fitness's business.

6. United States v. Yilmaz, et al., 00 Cr. 248, charges three defendants with securities fraud, from February 1998 to August 1998, in connection with a private placement of stock of Alliance Technology, an information technology services company located in Manhattan. The Complaint names as defendants HAYRI YILMAZ, Alliance's President and Chief Executive Officer, and KENNETH JEFFERSON and MERRICK C. SMITH, two persons hired by Alliance to recruit investors to purchase Alliance stock. The scheme allegedly involved falsely telling investors that an IPO for Alliance's stock was close at hand, paying secret bribes to brokers in return for their efforts in selling Alliance stock to unsuspecting investors, and telling investors that the proceeds of the private placement would be used in Alliance's business.

Additional Information

In connection with today's arrests, search warrants were executed at the following locations: (a) the offices of DMN Capital at 5 Hanover Square in Manhattan; (b) offices of the Detectives' Endowment Association; (c) the residence of STEPHEN GARDELL in Staten Island, New York; (d) residence of JAMES S. LABATE, a/k/a "Jimmy," in Staten Island, New York; (e) offices of ALLEN WOLFSON and Cyberamerica in Salt Lake City, Utah; and (f) offices of GENE PHILLIPS and A. CAL ROSSI at Basic Capital Management, in Dallas, Texas.

Simultaneously with today's announcement, the United States Securities and Commission announced the filing of three administrative proceedings alleging fraud-related charges against a total of 41 respondents. These include one administrative proceeding against 33 persons arising out of the private placement fraud at Monitor Investment Group; one against seven persons arising out of the conduct alleged in United States v. Wolfson, et al.; and one against WILLIAM STEPHENS. The SEC further announced that it had imposed halts in trading on the OTC Bulletin Board of securities issued by Wamex Holdings Inc., and E-Pawn, Inc.

Previously, NASD Regulation filed a complaint against 18 persons and Monitor Investment Group for fraud-related activities arising out of Monitor's activities with respect to Accessible Software, Inc. All defendants were fined and suspended and/or barred from associating with an NASD member.

Ms. WHITE praised the efforts of all of the law enforcement agencies involved, and particularly commended the outstanding investigative efforts of the FBI. Ms. WHITE also thanked the United States Securities and Exchange Commission for its assistance, and the Criminal Prosecution Assistance Group of NASD Regulation, Inc. for its help.

Assistant United States Attorneys PATRICK J. SMITH, DAVID C. ESSEKS, CHRISTOPHER J. CLARK, STEFANIE B. ISSER, MYLAN L. DENERSTEIN, and Special Assistant United States Attorney JASON SABOT are in charge of the prosecutions.

The charges contained in the Indictments and Complaints are merely accusations, and the defendants are presumed innocent unless and until proven guilty.

The names, date of birth, area of residence, charges, and maximum penalty per charge for each of the defendants is set forth on the attached chart.

0094 ###

U.S. Department of Justice

Federal Bureau of Investigation

Office of the Director

Washington, D.C. 20535

July 2, 1999

RECEIVED
JUL 8 1999
NASD
DISTRICT NO 7

Mr. Douglas McKinley
NASD Regulation, Inc.
Suite 500
One Securities Center
3490 Piedmont Road, N.E.
Atlanta, GA 30305

Dear Mr. McKinley:

It is a pleasure to join representatives of our Tampa Office in thanking you for your assistance in investigating the control of securities brokerage firms by organized crime and the resulting securities fraud and racketeering activities.

You were very kind to meet with the members of the investigative team, who benefitad greatly from your guidance. Also, I share their appreciation for the extensive time you devoted to recruiting informants, tracking leads of stock manipulation, and reviewing thousands of documents to trace securities fraud and offshore money laundering.

The success achieved in this case can be attributed in large measure to your superb efforts, and I want you to know of my personal gratitude for all you have done on behalf of the FBI in this case. It is good to know that we can count on your support in the fight against organized crime.

Sincerely yours,

Louis J. Freeh
Director

1 - Mr. Frank G. Zarb

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MEDIA RELEASE

Charles R. Wilson, United States Attorney for the Middle District of Florida announced today the unsealing of a Twenty-One Count Indictment charging Philip C. Abramo, a/k/a "Lou Metzer", 54; Philip Gurian, a/k/a "Martin Clainey, 38; Glen T. Vittor, 38; Louis Consalvo, 42; and Barry Gesser, 36, with violations of the Racketeered Influenced and Corrupt Organization Act (RICO), Mail Fraud, Wire Fraud, Securities Fraud and Money Laundering. The Indictment also seeks forfeiture of cash in the amount of $18,000,000, real property and bank accounts from the defendants.

According to the Indictment, the defendants associated themselves as an enterprise together with Sovereign Equity Management, Inc., and Falcon Trading Group, both Florida Corporations, to manipulate prices of certain stocks traded on the NASDAQ.

Notwithstanding the fact that only Vittor appeared on the corporate records of Sovereign and Falcon, Gurian, who was barred for life from the Securities Industry by the National Association of Securities Dealers (NASD), as well as Abramo, a "captain" or "capo" in the DeCavalcante Family of Cosa Nostra and Consalvo, a "made" member of that Crime Family, also had a hidden interest and exercised control over the operations of Sovereign and Falcon. Gesser assisted in obtaining deals for both Sovereign and Falcon.

According to the Indictment, the defendants approached corporations who were having financial difficulties with schemes to obtain financing through the sale of stock. The defendants were provided discounted stock of these corporations in exchange for providing interim financing and thereafter, distributed the stock to the public via "Regulation S" distributions and Initial Public Offerings. The defendants manipulated

the market through brokers employed by Sovereign who "pumped" up the price of the shares in order to make the most money for the defendants. The defendants, thereafter, "dumped" the stock upon the public. In order to assist in raising the price of the stock, the defendants caused false and fraudulent press releases to be issued regarding the financial condition and prospective business of the corporations. The Sovereign brokers were provided "juice" payments, or payment over and above the lawful commission, in order to sell the stock. After "dumping" their discounted shares, the defendants caused the Sovereign brokers to cease supporting the price of the stock. While the stock price plummeted, the defendants through Sovereign, Falcon and other entities, "shorted" the stock. Retail customers of Sovereign and the investing public lost all or the majority of their money in these securities.

The Indictment specifically charges that the distributions of Alter Sales, Inc., (ASCI), SC&T International, Inc. (SCTI), and International Standards Group (ISGI) which became Total World Telecommunications, Inc. (TWTI) were all "pump and dumps" orchestrated by the defendants.

If convicted, the defendants face twenty years imprisonment, and fines of up to twice the value of the property involved in the money laundering counts or a total of $36,000,000.

Mr. Wilson praised the investigative efforts of the Federal Bureau of Investigation and praised the cooperation of the Securities and Exchange Commission (SEC) as well as the National Association of Securities Dealers (NASD). The case is assigned to Assistant United States Attorney, Kevin R. March, Chief, Strike Force Unit.

An indictment is merely a formal charge of wrongdoing. Every defendant is presumed innocent unless and until he is proven guilty beyond a reasonable doubt.

SECURITIES FRAUD

The defendants are charged with RICO, Mail Fraud, Wire Fraud, Securities Fraud and Money Laundering, on whereby investors were solicited to invest in stocks while the defendants manipulated the price of the stocks traded on the NASDQ. The defendants allegedly "netted" in excess of $18,000,000.

DISTRICT ATTORNEY – NEW YORK COUNTY

NEWS RELEASE
July 27, 2000

CONTACT: Barbara Thompson
(212) 335-9400

Manhattan District Attorney Robert M. Morgenthau announced today the stock fraud indictment of securities firm D.H. BLAIR & CO., INC., and fifteen of its officers and employees for enterprise corruption. Included among those indicted are KENTON WOOD, the Chairman of the firm; ALAN STAHLER and KALMAN RENOV, the firm's Vice Chairmen; VITO CAPOTORTO, the head trader of the firm; ALFRED PALAGONIA, the top-producing broker for the firm; and ten other Blair brokers. In addition, three other former D.H. Blair brokers have pleaded guilty to felony charges arising from this investigation.

The sixteen defendants have all been indicted for Enterprise Corruption, Scheme to Defraud in the First Degree, and securities fraud in violation of the New York State General Business Law. The Grand Jury alleged additional pattern acts, including perjury and violation of New York's antitrust law. Various defendants were also indicted for Grand Larceny in the Third Degree and Falsifying Business Records in the First Degree. The Enterprise Corruption charge, which is punishable by up to twenty-five years' imprisonment, alleges that managers and stockbrokers at D.H. Blair ran the business as a criminal enterprise.

The 173-count indictment charges that the defendants participated in the "D.H. Blair Criminal Enterprise" from 1989 through 1998, and that the members of the scheme defrauded numerous people – including their own customers, other investors, other brokerage firms, and securities regulators – in order to realize massive illicit profits. Members of the D.H. Blair Criminal Enterprise conspired to commit, and did commit, a variety of crimes to advance their common criminal purpose. They manipulated stock prices -- including securities being offered in initial public offerings ("IPOs") -- for the benefit of the firm, certain favored customers, stockbrokers, and other people associated with D.H. Blair. They engaged in a wide range of illegal and high-pressure sales practices to generate excessive commissions and to facilitate the manipulation of stock prices. In addition, they illegally colluded with other securities firms to manipulate stock prices. They fraudulently increased commissions by selling securities to customers at far more than prevailing market prices. They increased the size of the firm's customer base by trafficking in client information stolen from other firms and by opening accounts for customers whom they knew were not suitable for the kind of high-risk securities marketed by D.H. Blair.

More than 50,000 customers invested with D.H. Blair & Co., Inc. during the period of the existence of the D.H. Blair Criminal Enterprise. Many suffered severe economic losses as a result of the criminal conduct of the enterprise. For example, a 56 year-old disabled man from Colorado lost approximately $150,000 from a disability settlement upon which he relied to pay for medicine and other living expenses; he was

given false price predictions and so-called "inside" information which did not pan out. Another investor, a 63 year-old disabled racetrack worker living on a fixed income in Manhattan, lost $35,000 of a $38,000 IRA due to unauthorized purchases in her account and refusals to sell. A tugboat pilot from Brooklyn lost the $45,000 she had saved to buy a house; while she was at sea, unauthorized trades were made in her account and when she complained she was falsely assured that she would be the recipient of windfall future profits. Another Blair customer, a 70 year-old Florida resident who had retired as a trumpet player for the New York Philharmonic, lost approximately $250,000 from his IRA and trust accounts due to false price guarantees and high pressure tactics designed to prevent him from selling.

D.H. Blair made large profits by fraudulently distributing and manipulating the securities of companies that had been brought public by its associated investment banking firm. In 1996, for example, the brokerage firm made gross profits of over $85 million from such over-the-counter securities trading. The indictment charges that among the IPOs that the D.H. Blair Criminal Enterprise fraudulently sold and manipulated were Amerigon, Inc., Telepad Corp., Premier Laser Systems, Inc., Interactive Flight Technologies, Inc., Sepregen Corp., Food Court Entertainment Network, Inc., Titan Pharmaceuticals, Inc., Digital Video Systems, Inc., Conversion Technologies International, Inc., and Advanced Aerodynamics and Structures, Inc.

In order to commit these crimes and evade detection, members of the D.H. Blair Criminal Enterprise falsified business records, suppressed customer complaints, hid illegal practices, gave false and evasive testimony, and otherwise misled regulators charged with enforcing the laws and rules governing the securities industry, including the United States Securities and Exchange Commission ("SEC") and the National Association of Securities Dealers ("NASD").

Mr. Morgenthau explained that some of the evidence leading to today's indictment was developed by NASD Regulation which worked closely with the District Attorney's Office during the investigation; the SEC also provided valuable assistance to the investigation.

Mary L. Shapiro, President of NASD Regulation said, "Today's action by District Attorney Morgenthau again demonstrates his commitment to help rid the securities markets of manipulative and fraudulent schemes. NASD Regulation previously brought actions against D.H. Blair and individuals named in this indictment which resulted in approximately $2.4 million in restitution to investors. We will continue to work closely with the District Attorney's Office and other law enforcement agencies to insure investor confidence and the integrity of our markets."

D.H. Blair, which ceased doing business as a broker-dealer in 1998, was located at 44 Wall Street in Manhattan.

The individual defendants include executives at the highest levels of D.H. Blair. As Chairman of D.H. Blair and a member of the firm's Senior Management Committee,

KENTON WOOD engaged in and supervised the frauds perpetrated by the criminal enterprise. WOOD, along with CAPOTORTO and PALAGONIA, also participated in collusive and fraudulent trading practices with A.R. Baron & Co., Inc., a securities brokerage firm started by former Blair employees; 13 Baron employees have been convicted of securities fraud in a previous case brought by the District Attorney's Office.

ALAN STAHLER and KALMAN RENOV were Vice Chairmen of the firm, members of the Senior Management Committee, and registered representatives. Both STAHLER and RENOV engaged in and supervised the frauds perpetrated by the criminal enterprise.

VITO CAPOTORTO was the head trader for D.H. Blair as well as a member of the Senior Management Committee. As such, in collusion with other members of the criminal enterprise, CAPOTORTO manipulated the prices of securities and knowingly handled fraudulent purchase and sales orders. WOOD, STAHLER, RENOV, and CAPOTORTO were also part owners of the D.H. Blair brokerage firm.

ALFRED PALAGONIA was the highest-earning salesman among the D.H. Blair registered representatives, personally generating as much as $13 million in gross commissions in one year. PALAGONIA was not licensed to act as a supervisor, but in fact he supervised members of the D.H. Blair sales force and directed their illegal activities.

ROBIN BREITNER, ALEX DEWAR, JOHN DIBELLA, STEVEN FRANTZ, RICHARD GAYDOS, RAYMOND HERNANDEZ, RICHARD MOLINSKY, DARREN ORLANDO, ANDREW SCHANDLER, and RICHARD SMITH, as registered representatives at D.H. Blair, fraudulently sold securities to the public, assisted in the manipulation of those securities, concealed material information they were legally required to disclose to their customers, and engaged in other frauds.

Former D.H. Blair brokers VINCENT POLISENO, PATRICK FALCO, and JAMES POVINELLI have each pleaded guilty to attempted enterprise corruption and securities fraud as part of the continuing investigation by the New York County District Attorney's Office into corrupt activities in the securities industry. The investigation into the affairs of D.H. Blair began in the fall of 1997. The investigation is ongoing.

Frauds Bureau Deputy Bureau Chief Steve Krantz, and Assistant District Attorneys Thomas J. Curran, Raja Chatterjee, and Patricia M. Sullivan of the District Attorney's Frauds Bureau handled the investigation of this case under the supervision of Daniel J. Castleman, Chief of the Investigation Division, and Owen Heimer, Chief of the Frauds Bureau. Investigators Christopher Donohue and George McMillin assisted in the investigation under the supervision of Assistant Supervising Investigator Angel Flores, Deputy Chief Investigator Thomas Jackson, Assistant Chief Investigator Terence Mulderrig, and Chief Investigator Joseph Pennisi.

Mr. Morgenthau thanked NASD Regulation, Inc. for its assistance, and especially Associate Vice President Evan Rosser, Supervisor of Examiners Neil Alexander, Bruce Bettigole and NASDR's Criminal Prosecution Assistance Group. Mr. Morgenthau also recognized the assistance of the Securities and Exchange Commission, thanking Division of Enforcement staff members including Associate Director William R. Baker III, Assistant Director Lawrence A. West, Branch Chief Gerald W. Hodgkins, and Senior Counsel Louis A. Randazzo.

United States Attorney
Southern District of New York

FOR IMMEDIATE RELEASE
SEPTEMBER 2, 1999

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PRESS RELEASE

MARY JO WHITE, the United States Attorney for the Southern District of New York, announced the filing of a 26-count Superseding Indictment today charging RANDOLPH PACE, ALAN NOVICH, WARREN SCHREIBER, VINCENT GREICO, ROBERT LANDAU, NANCY SHALEK, JUDAH WERNICK, STERLING FOSTER & COMPANY, INC., VTR CAPITAL, INC., and INVESTORS ASSOCIATES, INC., with securities fraud and related charges arising out of a scheme in which the defendants and their coconspirators made more than $200 million in illegal profits by defrauding public investors who purchased securities as part of 11 allegedly fraudulent public offerings. In

addition, PACE, NOVICH, and SCHREIBER are charged with conspiracy to commit money laundering.

In November 1998, PACE, the former owner of the defunct broker-dealer Rooney Pace, Inc., and NOVICH, an attorney and former dentist, were indicted on charges related to six public offerings involving Sterling Foster, a former Melville, Long Island, broker-dealer. The charges in today's Superseding Indictment include not only the six Sterling Foster public offerings, but also another five public offerings involving two additional broker-dealers, both of whom are named as defendants in the Superseding Indictment.

The first broker dealer is VTR Capital, with offices in New York, Colorado, Florida, Georgia, and Pennsylvania. The second is Investors Associates, a broker-dealer with offices in New York, New Jersey, and Florida.

In addition to naming Sterling Foster, VTR and Investors Associates as defendants, the Superseding Indictment also charges five new individual defendants with participating in the scheme. They include WARREN SCHREIBER, a former registered representative with VTR Capital; VINCENT GREICO, who co-managed the Melville, Long Island branch office of Investors Associates; JUDAH WERNICK, a principal of Patterson Travis, Inc., a broker-dealer with offices in New York; ROBERT LANDAU, an investor in three of the fraudulent offerings, and NANCY SHALEK, the Chairman

of three of the companies involved in the fraudulent offerings.

Simultaneous with the announcement of the Superseding Indictment, Ms. WHITE also announced the filing of charges against the following three co-conspirators for various crimes arising out of one or more of the 11 public offerings: (1) LAWRENCE PENNA, the former President and Chief Executive Officer of Investors Associates; (2) HERMAN EPSTEIN, the former Chairman of the Board of Directors and the Compliance Director of Investors Associates; and (3) DOUGLAS MANGAN, a former supervisor at the Melville, Long Island branch office of Investors Associates.

Ms. WHITE stated:

> Today's charges reflect our continuing investigation into the complex schemes orchestrated by Randolph Pace, Alan Novich, and their co-conspirators, in which they defrauded public investors in the market for public offerings, including initial public offerings. Having been disciplined and suspended by regulators for earlier improper conduct, Pace allegedly concealed his control of these offerings from regulators and the investing public, and then allegedly utilized secret agreements and understandings with "front" men and nominees to reap approximately $200 million in illegal profits for himself and his co-conspirators. Today's charges should serve notice that any violations of the federal securities laws, even the most creative and complex schemes, will be uncovered by law enforcement and aggressively prosecuted.

LEWIS D. SCHILIRO, Assistant Director in Charge of the FBI's New York Field Office, stated:

> Investor confidence in the securities markets is

critical. Market manipulations such as was concocted by these defendants unjustly enriches the dishonest at the expense of unwitting investors. It also greatly undermines public confidence in the safety and fairness of the markets.

LEE R. HEATH, Inspector in Charge, New York Division,

U.S. Postal Inspection Service, stated:

We congratulate the U.S. Attorney for the Southern District of New York for today's indictment. Once again, it is evident that law enforcement continues to work together against individuals who defraud the public. The Postal Inspection Service will continue to work aggressively within the law enforcement community to protect investors from being victimized.

RICHARD H. WALKER, Director of the Division of

Enforcement of the United States Securities and Exchange

Commission ("SEC") stated:

Criminal prosecution is the most effective deterrent to securities fraud. We applaud the work of the United States Attorney's Office for the Southern District of New York in this matter and look forward to continuing our successful working relationship.

MARY L. SHAPIRO, President of NASD Regulation, Inc.,

stated:

As microcap stock fraud victimizes individual investors and can undermine the public's confidence in our markets, today's action by United States Attorney Mary Jo White demonstrates her Office's commitment to bring to justice those who engage in this type of securities fraud. NASD Regulation previously brought enforcement actions against Sterling Foster, VTR Capital and Investors Associates, and many of the individuals named in today's indictment. Strong follow-up criminal prosecution is necessary when individuals who have been barred from the securities business by regulators seek to exert their influence in the markets through subterfuge and deception.

The Fraudulent Public Offerings

A. Pace's Alleged Control of Sterling Foster & VTR Capital

According to the Superseding Indictment, in or about late 1993 and early 1994, PACE, NOVICH, and SCHREIBER secretly assisted LIEBERMAN in establishing Sterling Foster as a securities broker-dealer. Among other things, PACE allegedly arranged to provide capital for Sterling Foster. In return, PACE allegedly was to receive Sterling Foster's net profits and to control its business activities, including dictating which public offerings of securities Sterling Foster would underwrite, the terms and conditions of those public offerings, and the amount of compensation to be received by LIEBERMAN. PACE, NOVICH, and LIEBERMAN allegedly agreed that PACE's control over Sterling Foster would remain secret and concealed from the SEC, the NASD, and the public.

According to the Superseding Indictment, in 1994 and early 1995, PACE, NOVICH, and SCHREIBER secretly obtained control over VTR Capital. Among other things, PACE, NOVICH, and SCHREIBER allegedly arranged to provide capital for VTR Capital, and controlled VTR Capital's business activities, including dictating which public offerings of securities VTR Capital would underwrite and the terms and conditions of those public offerings.

According to the Superseding Indictment, PACE, NOVICH,

SCHREIBER, LIEBERMAN and their co-conspirators allegedly agreed that PACE's control over Sterling Foster and PACE and SCHREIBER's control over VTR Capital would remain secret and concealed from the SEC, the NASD, and the public. Such concealment was necessary, according to the charges, because PACE had at that time been suspended for two years from associating with any NASD member firm, and was prohibited from working in a supervisory capacity for any NASD member firm for an additional five years.

In addition, in October 1986 and November 1987, the SEC had barred PACE for various periods from associating with, or acting as a principal for, any broker-dealer. SCHREIBER was in the process of appealing NASD disciplinary actions that had barred him permanently from association with any NASD member, and had been suspended for five days by the NASD in May 1994 from associating with any NASD member. To effect this concealment, according to the charges, Sterling Foster and VTR Capital submitted to the SEC and the NASD Form B-Ds that failed to disclose, among other things, the true roles PACE and SCHREIBER played in connection with these broker-dealers.

B. **The Issuers**

According to the Superseding Indictment, once PACE, NOVICH, and SCHREIBER secretly controlled Sterling Foster and VTR Capital, they arranged for the firms to be involved in public offerings for the following companies (the "Issuers"), as

described below:

1. Lasergate Systems, Inc.: in October 1994, Sterling Foster underwrote a $4.4 million public offering for Lasergate, a Florida corporation engaged in the development, assembly, marketing, servicing, and installation of admission control and revenue accounting systems at amusement parks, theme parks, and other public facilities.

2. Advanced Voice Technologies, Inc.: in February 1995, Sterling Foster underwrote a $5.5 million initial public offering ("IPO") for Advanced Voice, a Delaware corporation engaged in the sale and support of a "Homework Hotline" voice processing system designed for use in education.

3. Com/Tech Communication Technologies, Inc.: in August 1995, Sterling Foster underwrote a $5 million IPO for Com/Tech, a New York corporation engaged in the business of developing, designing, and managing interactive video programming and private satellite networks for live one-way and interactive video programs and tele-conferencing.

4. Embryo Development Corporation: in November 1995, Sterling Foster underwrote a $5 million IPO for Embryo, a Delaware corporation engaged in the development, acquisition, manufacturing, and marketing of biomedical devices.

5. Applewoods, Inc.: in April 1996, Sterling Foster underwrote a $6 million IPO for Applewoods, a Delaware corporation that manufactured and sold natural soaps, oils, lotions, toiletries, and related products.

6. ML Direct, Inc.: in September 1996, Patterson Travis, Inc., and others underwrote a $7.2 million IPO for ML Direct, a Delaware corporation engaged in the business of expanding the marketing opportunities for products that had already been successfully sold on "infomercials" and home shopping networks.

7. Interiors, Inc.: in September 1995 VTR Capital and Investors Associates, among others, underwrote a $2,010,000 public offering of securities for Interiors, a Delaware corporation engaged in the manufacturing and marketing of picture frames.

8. Compare Generiks, Inc.: in March 1996, VTR Capital and Investors Associates underwrote a $3,450,000 IPO of securities for Compare Generiks, a Delaware corporation engaged in the distribution, marketing, and sale of dietary supplements and over-the-counter, non-prescription pharmaceuticals.

9. Perry's Majestic Beer, Inc.: in July 1996, VTR Capital and Investors Associates underwrote a $3,500,600 IPO of securities for Perry's Majestic Beer, a Delaware corporation, engaged in, among other things, the marketing and sale of micro-brewed beers and ales.

10. Decor Group, Inc.: in November 1996, VTR Capital and Investors Associates underwrote a $3,250,000 IPO of securities for Decor, a Delaware corporation engaged in the design, manufacturing, and marketing of sculptures.

11. Superior Supplements, Inc.: in February 1997, VTR Capital and Investors Associates underwrote a $6 million offering of Superior Supplements securities. Superior Supplements was a Delaware corporation engaged in the development, manufacture, marketing, and sale of dietary supplements.

The last five companies were added in the Superseding Indictment.

According to the Superseding Indictment, PACE, NOVICH, and SCHREIBER dictated the terms and conditions of these public offerings, including the selection of the underwriters, the number of shares to be registered, the offering price, and the lawyers and accountants selected to work on the offerings.

C. PACE's and NOVICH's Allegedly Undisclosed Interest in the Public Offerings

According to the Superseding Indictment, in order to enrich themselves, PACE and NOVICH obtained for themselves, directly and through nominees, an undisclosed beneficial

ownership of a substantial percentage of the common stock of the Issuers by, among other methods: (1) securing so-called "founders stock" for themselves and their nominees; (2) causing certain of the Issuers to issue debt and equity securities to investors, including PACE, NOVICH, and their nominees, in "bridge financings" pending the public offerings; and (3) requiring certain of the Issuers to give stock to so-called "consultants" selected by PACE and NOVICH in exchange for actual and fictitious consulting services. PACE, NOVICH, their nominees, and others who were issued stock of the Issuers in connection with the public offerings are referred to collectively as the "Selling Securityholders".

PACE, NOVICH, and SCHREIBER allegedly dictated the number of shares to be registered on behalf of the Selling Securityholders, and caused the Issuers to register such securities in the registration statements filed in connection with the public offerings. At the same time, PACE, NOVICH and SCHREIBER allegedly concealed from the regulators and the investing public that they had a secret understanding with certain of the Selling Securityholders that PACE and NOVICH would share beneficial ownership of their securities, including the power to sell the securities and share in the profits.

D. **Fraudulent Sales to Public Investors**

According to the Superseding Indictment, the defendants

had an unlawful, secret understanding, reached prior to the effective dates of the offerings, pursuant to which, among other things, (i) the selling securityholders agreed to sell the securities registered on their behalves to Sterling Foster, VTR Capital, or Investors Associates, at pre-arranged times and prices, as designated by PACE, NOVICK, and SCHREIBER; (ii) the prices at which the selling securityholders would effect these sales would result in a substantial profit to many of the selling securityholders, but be at prices substantially below the expected market price for those securities following the offerings; (iii) Sterling Foster, VTR Capital and Investors Associates would sell substantial amounts of the Issuers' securities to their retail customers, and use securities purchased from the selling securityholders at the pre-arranged times and prices to cover the sales to retail customers; and (iv) this plan would not be disclosed to the public.

According to the Superseding Indictment, in order for the defendants to enrich themselves in this scheme, it was necessary to create strong demand among public investors for the securities sold as part of the public offerings. Thus, Sterling Foster and Investors Associates allegedly caused their sales forces unlawfully to generate extraordinary demand in connection with the public offerings and secondary market trading for the securities of the Issuers by engaging in unlawful, abusive sales

practices, including: (a) making misrepresentations and omissions of material facts to their customers about the Issuers, the offerings, and the securities; and (b) unlawfully confirming sales to their customers of securities sold in the public offerings and in the secondary market, before the offerings were declared effective by the SEC.

According to the Superseding Indictment, as a result of the misrepresentations and omissions made by Sterling Foster to public investors, Sterling Foster, with the knowledge and approval of PACE and NOVICH, accumulated multi-million-dollar "short" positions for the securities of the Issuers in its proprietary trading account immediately after the public offering. Sterling Foster's "short" positions were in amounts substantially greater than the number of freely tradeable shares in the marketplace. In order to cover these "short" positions, PACE, NOVICH, LIEBERMAN, and WERNICK allegedly pursuant to the secret understanding with certain of the Selling Securityholders, including LANDAU and SHALEK, caused Sterling Foster and Patterson Travis to release the Selling Securityholders from the sham "lock-up" agreements, and caused Sterling Foster to purchase such securities at pre-arranged prices.

The pre-arranged prices allegedly determined by PACE and NOVICH were designed to result in a substantial profit to many of the Selling Securityholders, including LANDAU and SHALEK,

but at prices substantially below the public offering price and the expected market price for those securities following the offering.

According to the Superseding Indictment, PACE, NOVICH, LIEBERMAN, and others, then caused Sterling Foster to cover its "short" positions with securities purchased from the Selling Securityholders. As a result of this secret arrangement, PACE and NOVICH and their co-conspirator were allegedly able to earn millions of dollars in illegal profits. Sterling Foster allegedly obtained its share of the illegal profits in the form of the "spread" between the low price it paid for the "unlocked" securities purchased from the Selling Securityholders, and the high price it received upon first selling stock to the investing public in amounts greater than the number of shares freely tradeable in the marketplace, and then covering the resulting "short" positions with the lower-priced, "unlocked" securities it had purchased from the Selling Securityholders.

According to the Superseding Indictment, in connection with the VTR/Investors Associates Public Offerings, PACE, NOVICH, SCHREIBER, and GREICO, as well as Lawrence Penna, Herman Epstein, and their co-conspirators, caused VTR Capital and Investors Associates to effect sales of the securities registered on behalf of the selling securityholders by (i) causing VTR Capital and Investors Associates secretly to work together to increase the

price for the Issuers' securities after the offering to a desired "target price" set by PACE, SCHREIBER, and their co-conspirators; (ii) causing certain selling securityholders in the VTR/Investors Associates Public Offerings to sell the securities to VTR Capital and Investors Associates in large blocks at pre-arranged prices that were typically substantially below the target price and expected market price for those securities, and (iii) causing VTR Capital and Investors Associates to use these securities to cover their sales to retail customers, thereby earning millions of dollars of trading profits.

According to the Superseding Indictment, through this illegal scheme, PACE, NOVICH, SCHREIBER, GREICO, WERNICK, LANDAU, SHALEK and others thereby caused Sterling Foster, VTR Capital, and Investors Associates to violate their fiduciary and other duties to their customers by, among other things: (a) failing to give their customers fair and honest advice about the value of the securities sold in the public offerings of the Issuers; and (b) preparing registration statements, prospectuses, and other documents in connection with the public offerings that contained misrepresentations and omissions of material fact about, among other things, the plan of distribution with respect to, and the beneficial ownership of, certain of the securities registered in the offerings.

Six defendants have already pled guilty to charges

relating to their involvement in the scheme, and have agreed to forfeit or disgorge to the Government approximately $32 million in ill-gotten gains. These six defendants include ADAM LIEBERMAN, the former President of Sterling Foster; SHERMAN DRUSIN, the former director of corporate finance for Sterling Foster; MICHAEL KRASNOFF, the former President and CEO of PDK Labs, Inc., a Long Island based pharmaceutical company; MICHAEL LULKIN, the former General Counsel to PDK; HARTLEY BERNSTEIN, a securities lawyer and former name partner of the law firm Bernstein & Wasserman; and WILLIAM HURLEY, an investor.

PACE, 53, NOVICH, 52, LANDAU, 57, and PENNA, 55, all live in Manhattan.

SCHREIBER, 43, lives in Roslyn Heights, New York.

GREICO, 33, lives in West Islip, New York.

SHALEK, 44, lives in Purchase, New York.

WERNICK, 35, lives in Woodmere, New York.

EPSTEIN, 58, lives in Franklin Lakes, New Jersey.

MANGAN, 37, lives in Amityville, New York.

The exact charges brought against each defendant, and the maximum penalties for those charges, are summarized in the attached schedule.

In separate actions, the SEC announced the filing and settlement of civil securities fraud charges against LAWRENCE PENNA, HERMAN EPSTEIN, and DOUGLAS MANGAN.

Ms. WHITE praised the efforts of the Federal Bureau of Investigation and the United States Postal Inspection Service for their investigation of this case. Ms. WHITE also praised the assistance provided to the investigation by NASD Regulation, Inc. and the SEC. The investigation is continuing.

Assistant United States Attorneys RICHARD M. STRASSBERG and JOANNA HENDON are in charge of the prosecution.

The charges contained in the Superseding Indictment are merely accusations, and the defendants are presumed innocent unless and until proven guilty.

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Defendant	Charge	Number of Counts	Maximum Penalty Per Count
RANDOLPH PACE ALAN NOVICK	Conspiracy to commit securities fraud, mail fraud, wire fraud, and to make false statements	1	5 years; fine: $250,000 or twice the gross gain or loss from the offense
	Securities Fraud	11	10 years; fine: $1 million or twice the gross gain or loss from the offense
	Making False Statements and Omissions in Registration Statements	11	5 years; fine: $250,000 or twice the gross gain or loss from the offense
	Making False Statements and Omissions in the Form B-D	2	10 years; fine: $1 million or twice the gross gain or loss from the offense
	Conspiracy to Commit Money Laundering	1	20 years; fine: the greater of $500,000 or twice the value of the property involved in the offense;

Defendant	Charge	of Counts	Per Count
WARREN SCHREIBER	Conspiracy to commit securities fraud, mail fraud, wire fraud, and to make false statements	1	5 years; fine: $250,000 or twice the gross gain or loss from the offense
	Securities Fraud	10	10 years; fine: $1 million or twice the gross gain or loss from the offense
	Making False Statements and Omissions in Registration Statements	10	5 years; fine: $250,000 or twice the gross gain or loss from the offense
	Making false Statements and Omissions in the Form B-D	2	10 years; fine: $1 million or twice the gross gain or loss from the offense
	Conspiracy to Commit Money Laundering	1	20 years; fine: the greater of $500,000 or twice the value of the property involved in the offense;

Defendant	Charge	Number of Counts	Maximum Penalty Per Count
VINCENT GREICO INVESTORS ASSOCIATES	Conspiracy to commit securities fraud, mail fraud, wire fraud, and to make false statements	1	5 years; fine: $250,000 or twice the gross gain or loss from the offense
	Securities Fraud	5	10 years; fine: $1 million or twice the gross gain or loss from the offense
	Making False Statements and Omissions in Registration Statements	5	5 years; fine: $250,000 or twice the gross gain or loss from the offense
JUDAH WERNICK	Conspiracy to commit securities fraud, mail fraud, wire fraud, and to make false statements	1	5 years; fine: $250,000 or twice the gross gain or loss from the offense
	Securities Fraud	4	10 years; fine: $1 million or twice the gross gain or loss from the offense
	Making False Statements and Omissions in Registration Statements	1	5 years; fine: $250,000 or twice the gross gain or loss from the offense

Mr. GOLDSMITH. Thank you.

One of these cases, and I believe we may hear some tapes from it later on, is known as the Mob on Wall Street case, which involves secret organized crime control of brokerage firms to manipulate the price of Healthtech stock by upticking their quotes and bribing brokers. In that matter NASDR's market regulation department first identified problematic accounting and disclosure irregularities as well as suspicious Internet activity. This was referred to the government for action. After the government initiated its investigation, CPAG provided hundreds of hours of assistance to the prosecutors in that case. In the ultimate trial of that case, which led to a conviction, our director of enforcement provided important expert testimony to the jury.

In addition to assisting law enforcement officials and prosecuting organized crime, the NASDR has provided a taping rule to reduce recidivism by brokers. The rule requires a firm to tape record all of its brokers sales calls with existing and potential customers if a significant percentage of a firm's brokers were previously employed by problem firms. When brokers migrate from firm to firm, they do not necessarily lose their old bad habits.

NASDR has also provided and will continue to provide training programs on securities issues to prosecutors around the country.

In closing, I want to emphasize that we are committed to providing a fair, well-regulated environment for the trading of all securities free of the taint of organized crime. We promise to continue to work diligently with the SEC, the States, and law enforcement officials and Congress toward that end. Thank you very much.

[The prepared statement of Barry R. Goldsmith follows:]

PREPARED STATEMENT OF BARRY R. GOLDSMITH, EXECUTIVE VICE PRESIDENT, NASD REGULATION, INC.

The NASD would like to thank the Subcommittee for this opportunity to testify on organized crime in the securities markets, the scope of the problem and our efforts to address it. America's securities markets are essential to the capital formation process and economic well being of our nation. It is our job to work together with the SEC and law enforcement authorities to protect investors and the markets from fraud and abuse of any kind, including organized crime.

Your invitation letter asked us to discuss, among other things, the level of organized crime that NASDR has discovered in our capital markets through brokerage houses or other NASDR regulated entities. In addition, you requested that we discuss past, present and future efforts to detect and prevent organized crime in the securities markets, as well as the results of these efforts.

Our securities markets are the strongest, safest and best regulated markets in the world. The overwhelming majority of individuals in the securities industry are honest, ethical professionals who treat their obligation to comply with the law seriously and put the investor's interest first. There are, however, a small number of dishonest individuals and firms in the securities business. The problem firms and brokers represent a tiny portion of the almost 5,600 securities firms and more than 650,000 registered industry professionals in this country. Importantly, only a tiny fraction of these are involved in criminal activity and an even smaller number are involved with organized crime. Nevertheless, any attempt, however limited or small, by organized criminal elements to influence the securities markets is unacceptable. We will not tolerate it. NASD Regulation, along with the SEC and criminal prosecutors, have stepped up its already significant surveillance, enforcement and prosecutorial efforts to rid the industry of these criminals and to better educate and protect the investing public. The recent spate of successful organized crime prosecutions in securities cases, and NASD Regulation's substantial assistance to criminal prosecutors in those cases, demonstrates our strong commitment and success in this area.

I believe that the securities industry may be a target for organized crime for several reasons. We have experienced the longest sustained bull market in the history

of our country. This market has attracted record numbers of new, sometimes relatively unsophisticated, individuals as investors. Inexperienced investors looking for a quick doubling or tripling of their money can too easily fall prey to those unscrupulous few in our industry and on its fringes. In addition, the number of small, newly capitalized companies in the non-listed or over-the-counter markets has increased. While many of these smaller companies provide significant growth potential for our capital markets and investors alike, these companies' securities are also much more susceptible to manipulative conduct. This can be done the "old fashioned way" through rows of telephone banks housed in "bricks and mortar" boiler rooms, or now, much more efficiently, with a few clicks of the mouse over the Internet.

As securities regulators, we must adopt a "zero-tolerance" approach not just to organized crime, but to any criminal conduct in the securities marketplace. We must continue to look at ways of improving our enforcement and surveillance, as well as the rules we adopt to protect investors, especially as it concerns organized crime. Most importantly, we must also look at new ways of "investor outreach," so that the individual investor is armed with the information he or she needs to resist the criminals and scamsters and make responsible investment decisions. This is the best defense to any type of securities fraud.

THE NASD

Let me briefly outline the role of the NASD in the regulation of our securities markets. Established under authority granted by the 1938 Maloney Act Amendments to the Securities Exchange Act of 1934, the NASD is the largest self-regulatory organization for the securities industry in the world. Every broker dealer in the U.S. that conducts a securities business with the public is required by law to be a member of the NASD. The NASD's membership comprises almost 5,600 securities firms that operate in excess of 83,000 branch offices and employ more than 652,000 registered securities professionals.

The NASD is the parent company of NASD Regulation, Inc. (NASDR), the Nasdaq Stock Market, Inc., the American Stock Exchange LLC, and NASD Dispute Resolution, Inc. These subsidiaries operate under delegated authority from the parent, which retains overall responsibility for ensuring that the organization's statutory and self-regulatory functions and obligations are fulfilled. The NASD is governed by a 31-member Board of Governors, a majority of whom are not securities industry affiliated. The NASDR subsidiary is governed by a 10 member Board of Directors, balanced between securities industry and non-industry members. Board members are drawn from leaders of industry, academia, and the public. Among many other responsibilities, the boards, through a series of standing and select committees, monitor trends in the industry and promulgate rules, guidelines, and policies to protect investors and ensure market integrity.

NASD Regulation

NASD Regulation is responsible for the registration, education, testing, and examination of member firms and their employees. In addition, we oversee and regulate our members' market-making activities and trading practices in securities, including those that are listed on the Nasdaq Stock Market and those that are not listed on any exchange. Although activities involving these securities may be reflected in different quotation media, NASDR is ultimately responsible for regulating the trading activity of its members whether it occurs in the Nasdaq Stock Market, the over-the-counter market, or any other area over which the NASD has jurisdiction.

In 1999, NASDR brought 1,175 new enforcement actions involving violations of the federal securities laws and NASD rules. This represents approximately a 12 percent increase from the prior year and more than a 30 percent increase over the past five years. In addition, NASDR barred nearly 500 individuals from the securities industry in 1999, almost a 30 percent increase from 1998.

The 1,500 member staff of NASDR is devoted exclusively to carrying out the NASD's regulatory and enforcement responsibilities. NASDR carries out its mandate from its Washington headquarters and 14 district offices located in major cities throughout the country. Through close cooperation with federal and state authorities and other self-regulators, overlap and duplication is minimized, freeing governmental resources to focus on other areas of securities regulation.

NASDR rulemaking is a widely participatory process with broad input from industry members, other regulators, and the public. By the requirements of the Securities Exchange Act of 1934, NASDR rules do not become final until they are filed with and approved by the SEC. The SEC staff carefully reviews each rule filing and publishes NASDR rules for comment in the *Federal Register*.

NASDR has examination responsibilities for all of its 5,600 members. In addition to special cause investigations that address customer complaints and terminations

of brokers for regulatory reasons, NASDR has established a comprehensive routine cycle examination program. This program is carried out through a regulatory plan that focuses each District's examination efforts on the firms, individuals, issues and practices that present the greatest regulatory challenges and concerns. Annual on-site inspections are conducted of high priority areas. In addition, NASDR has established an examination frequency cycle for all of its members, which is based upon the type of business conducted by the member, the scope of that business, the extent of customer exposure, method of operation, past regulatory history, and other factors. During 1999, more than 2,400 main office routine examinations were completed and over 6,700 customer complaints and 2,900 terminations for cause were investigated.

Another key factor in NASDR's overall regulatory program involves developing and administering qualifications testing for securities professionals. All sales and supervisory persons associated with NASD member firms must demonstrate a requisite understanding of the products offered by their firms, as well as regulatory requirements for the functions they are to perform for their employer-members. Individuals acting in a management capacity must pass the appropriate principal's examination, while sales personnel must demonstrate specific understanding of the products they intend to sell and the regulations that govern those products. In 1999, NASDR administered 353,778 qualifications tests.

NASDR's Central Registration Depository (CRD) maintains the qualification, employment, and disciplinary histories of more than 650,000 registered securities employees of member firms through this automated, electronic system. Developed jointly by the North American Securities Administrators Association (NASAA), the organization of state securities regulators, and the NASD, CRD is an on-line registration data bank and application-processing facility to which each of its regulatory participants are linked by a nationwide network of on-line computer terminals.

Records of securities professionals are available to the public through NASDR's Public Disclosure Program. Background information is supplied, including all reportable criminal convictions and dismissed indictments, final disciplinary actions taken by the NASD or any other securities self-regulatory organization and state and federal regulators, pending NASD and other SRO disciplinary actions, dismissed NASD complaints, arbitration decisions, and civil judgments in securities or commodities disputes. This information is provided without charge to requestors.

The Over-The-Counter Market

The NASD has regulatory responsibilities for what is known as the OTC or over-the-counter market. The over-the-counter market is a vast amalgam of publicly traded companies that list *neither* on Nasdaq *nor* on any exchange. It is in the thinly traded, micro-cap securities that characterize the over-the-counter-market where we find the greatest potential for fraudulent activity.

A part of the over-the-counter market is what is known as The OTC Bulletin Board (OTCBB). While it is a system operated by Nasdaq, the Bulletin Board is markedly different and distinct from the Nasdaq Stock Market. It is an electronic quotation service for subscribing members. While the system displays real-time quotes, last sale prices, and volume information in domestic securities, there is no formal legal relationship between the OTC issuers whose shares are quoted there and Nasdaq. The companies need not meet any listing standards to have their stock included in the Bulletin Board. This system provides a centralized and automated alternative to the Pink Sheets, which historically have been published on paper once each day, but which are now available electronically.

Until recently, there were no periodic public reporting requirements for companies who wanted their shares included on the OTCBB. Thus, investors who wanted to evaluate the merits of companies whose shares were quoted there, had little available information. In January 2000, the SEC approved the NASD's OTC Bulletin Board Eligibility Rule. This rule permits only those companies that report their current financial information to the SEC, banking, or insurance regulators to be quoted on the OTCBB. This new rule ensures that investors are provided with more and better information about OTCBB stocks. In particular, investors will now have access to companies' current financial information when considering investments in OTCBB securities.

NASDR CRIMINAL ENFORCMENT ACTIVITIES

The U.S. securities industry is one of the most comprehensively regulated in the country. This regulation has helped make our markets the deepest and safest in the world. In the overwhelming majority of situations, securities rule violations by market participants can be and are dealt with by administrative or civil sanctions. NASDR's administrative sanctions include suspensions and bars of registered rep-

resentatives, business restrictions on or expulsions of member firms, restitution to customers, and the imposition of monetary fines. We believe that this comprehensive web of regulation is a major reason that the limited organized crime involvement in the industry that we have seen to date has rarely been by those who are registered to operate in the industry, but rather by those who operate outside the periphery of that regulation.

There are, however a very small number of violations that are so pernicious or are committed by such hardened securities law recidivists that they can only be dealt with criminally. Importantly, NASDR jurisdiction extends only to member securities firms and their associated persons, and thus does not have the jurisdictional reach or the necessary array of governmental investigative tools—wiretap, search warrant and subpoena authority—that are available to the FBI and other law enforcement officials. While we pursue our own investigations and take administrative action against registered persons and entities in these types of cases, we also refer the most serious of these matters to criminal law enforcement officials. It is the criminal authorities who are best positioned to fully prosecute those involved in these cases. In these instances, we work closely with the criminal authorities to assist them in any way we can.

The type of assistance we provide to criminal authorities depends upon the nature of the case and the needs of the particular prosecutor. Many of these cases involve very complex fraudulent schemes with thousands of customer trades, months if not years of illicit activity and tens of millions of dollars of illegal profits. While prosecutors often obtain important evidence in these cases from informants, coconspirators, and wiretap evidence, not all of this evidence may be of the quality necessary to bring a successful criminal prosecution. Criminal cases require proof of guilt beyond a reasonable doubt.

NASDR has unique access to the audit trail that accompanies nearly every securities trade. This audit trail includes detailed information on the billion-plus shares that trade hands in our markets each day, each share of which must be reported within 90 seconds of a trade to power computer systems we maintain. Likewise, we capture and maintain, on a real time basis, every quote to buy or sell a security and every change to those quotes that brokerage firms make in these securities.

Our investigators come from a variety of securities industry and professional backgrounds and are well versed in the technical and sometimes difficult to understand language of the securities industry. They are also computer proficient and are able to efficiently analyze thousands of trades and quotes to detect patterns of potentially illicit conduct. Working side-by-side with criminal prosecutors, they are able interpret tape recordings, heavily laden with technical jargon. Likewise, they are able to recreate the trading in particular securities that may corroborate the testimony of a cooperating witness that the trading in that security was manipulated.

NASDR investigators are able to work with criminal prosecutors to graph and chart the evidence into compelling demonstrative exhibits that can be presented to the jury at trial. Sometimes, NASDR investigators and examiners serve as fact witnesses in criminal trials, describing to the jury the underlying factual basis of demonstrative exhibits or compilations of trading data. On other occasions, in organized crime and other criminal matters, NASDR officials have served as expert witnesses explaining the regulations and workings of the securities markets.

NASDR has reacted to the potential criminal conduct primarily through three approaches: (1) Stepped-up assistance to criminal prosecutors through its recently formed Criminal Prosecution Assistance Group (CPAG), as well as through its Market Regulation Department; (2) Implementation of its new taping rule; and (3) Enhanced training of federal, state and local prosecutors and law enforcement officials.

CPAG, Market Regulation, and Other Assistance to Prosecutors

Our commitment to assisting criminal prosecutors has been on-going and of a long-standing nature. The NASD's record of assistance to and cooperation with criminal authorities goes back many years. At least as early as the 1980's, the NASD had investigative staff working full-time to assist in the investigation and criminal prosecution of securities fraud. We continue to play an active role in this work through close relationships between our 14 district offices and prosecutors in their locales.

Our Market Regulation Department conducts an ongoing surveillance program of the market activity for all Nasdaq and over-the-counter securities. While this is an enormous task given that it includes watching over 10,000 securities on a daily basis, NASDR has committed significant resources to develop technology to identify suspicious scenarios that require further investigation. Our surveillance staff works closely with the U. S. Securities and Exchange Commission and criminal law enforcement agencies and has quickly uncovered numerous fraud schemes that have

been successfully investigated and prosecuted. In 1999, the Market Regulation Department referred over 230 cases of potential insider trading and fraud to the SEC and other law enforcement agencies.

To ensure that prosecutors have the expertise and support that they need to bring securities cases, and responding to the numerous requests of criminal law enforcement officials, NASDR's Enforcement Department created the Criminal Prosecution Assistance Group, or CPAG, in April 1998. It is through CPAG that NASDR most directly takes part in the fight against organized crime in the securities industry.

The purpose of CPAG is to make available to criminal prosecutors and investigating agents throughout the country the expertise and experience of the NASD for the identification, investigation and prosecution of securities fraud and related offenses. CPAG is the first unit within a self-regulatory organization to be devoted to working directly and exclusively on criminal investigations and prosecutions involving securities-related crimes.

The office is headed by a CPAG Chief Counsel who was both a Special Assistant United States Attorney and an Assistant Chief Litigation Counsel with the SEC. The group includes securities examiners who are widely experienced and knowledgeable about the securities industry generally, the computerized databases of the NASD, and the analysis of trading records maintained in the industry.

CPAG has been involved in about 200 separate criminal matters, ranging from hundreds of hours of work on lengthy investigations and trials to brief telephone consultations with prosecutors and agents. The group provides detailed analysis of trading records and related documentation, offers advice and training to prosecutors and agents, provides summary and expert testimony, creates demonstrative exhibits, assists with complex securities law motions, and provides attorney assistance through appointment as a Special Assistant United States Attorney or Deputy District Attorney. Many of these matters involve non-public investigations, and thus cannot be disclosed.

Cases

CPAG and the Market Regulation Department have assisted criminal prosecutors on all of the significant publicly available matters involving allegations of Mob activity in the securities markets, including the following cases:

U.S. v. Gangi, et al.—United States Attorney's Office (SDNY)—This case was the first prosecution of organized crime involvement in the securities industry, and came to be known as the "Mob on Wall Street" case. It involved secret organized crime control of several brokerage firms to manipulate the price of Healthtech common stock and warrants by artificially upticking their quotes and bribing brokers to provide retail. All of the organized crime figures pleaded guilty, and the remaining defendants, including a notorious stock promoter named Gordon Hall, were convicted at trial on May 11, 1999. The charges included racketeering and conspiracy as well as securities fraud. Hall was sentenced to 87 months in prison. The organized crime figures received sentences ranging from 4-8 years in prison.

NASDR provided hundreds of hours of assistance to the SEC and prosecutors on this important case. NASDR's Market Regulation Department referred it to the Nasdaq Listing Investigations Department to investigate questionable assets, potential false disclosures by the company, suspicious Internet activity, and a significant increase in the total shares outstanding. Evidence uncovered in the resulting investigation was referred to the government. After the government initiated its investigations, CPAG analyzed trading data, reviewed transcripts of government tape recordings post-indictment and identified data that corroborated particular statements on the tapes, such as statements by Mob associates about manipulation of Healthech's stock on particular days. CPAG prepared demonstrative exhibits, such as a comparison of the reported brokers' commissions to the conspirators' secret listing of actual payments of bribes to brokers. CPAG also created bar charts that graphically displayed the dominance of the corrupt brokerage firm in sales to the public of Healthtech common stock and warrants. NASDR staff also participated in interviews of cooperating witnesses and a defendant who ultimately pleaded guilty. NADR also provided expert witness testimony in the trial of this case.

U.S. v. Ageloff, et al.—United States Attorney's Office (EDNY)—This on-going matter involves fraudulent sales practices and manipulation of Initial Public Offerings (IPOs). Ageloff was reported in the media to have extensive Mob connections. The defendants in this case included primarily top producing brokers and managers from the brokerage firms of Hanover Sterling, Norfolk Securities, Capital Planning, and PCM Securities. Approximately 50 of these defendants have agreed to plead guilty in this case. CPAG's Chief Counsel is serving as a Special Assistant U. S. Attorney and will assist in the trial of the remaining seven defendants, currently

scheduled to begin October 30. CPAG is also assisting in analyzing trading records, creating demonstrative exhibits, and preparing for summary trial testimony.

U.S. v. Coppa, et al.—United States Attorney's Office (EDNY)—This IPO manipulation case involves 19 defendants, including the principals of the brokerage firms of State Street and White Rock Partners. It also involves members of the Gambino, Genovese, Bonnano, and Colombo crime families who had been enlisted by other defendants to settle internal disputes. CPAG was extensively involved in analyzing data and interviewing potential witnesses in this matter over an 18-month period, and will provide summary trial testimony and demonstrative trial exhibits.

"UPTICK" Indictments—United States Attorney's Office (SDNY)—In June 2000, the U.S. Attorney for the Southern District of New York announced criminal charges against 120 defendants named in 21 separate charging documents, as part of "Operation Uptick." The defendants included members and associates of all five New York Mob families, and allegations that they had controlled or infiltrated several brokerage firms, including First Liberty Investment Group, William Scott & Company, Bryn Mawr Investment Group, Monitor Investment Group, Meyers Pollack & Robbins, and Atlantic General Financial Group. The cases included allegations of kickbacks to an investment adviser in connection with a New York Stock Exchange listed Real Estate Investment Trust (American Realty Trust), as well as a union pension fund. The allegations included fraudulent Internet touting of stocks, fraudulent private placements, pump and dump schemes, prearranged trades, bribes, "no net sales" policies, and brokers being subjected to "beatings, intimidation and threats."

Market Regulation and CPAG have provided trading analyses and background information from the NASD's Central Registration Depository, as well as customer loss information for purposes of sentencing calculations, and plans extensive involvement in assisting the U.S. Attorneys Office and the FBI in trial preparation.

U.S. v. Abramo—United States Attorney's Office (SDFL)—This case involved "pump and dump" manipulations by a brokerage firm named Sovereign Equity Management Corporation, which a "capo" in the Decavalcante crime family, Philip Abramo, secretly controlled. NASDR's Atlanta district office and, to a lesser extent, CPAG, assisted in this matter in Tampa.

People v. Spero—Manhattan District Attorney—CPAG assisted the Manhattan District Attorney in this case involving an alleged enforcer for the Genovese crime family. This securities fraud consisted of telemarketers posing as brokers and selling fictitious stock in imaginary trucking companies. All of the defendants pleaded guilty, and the alleged Genovese enforcer is serving up to 5 years for securities fraud.

Other Matters

CPAG and the Market Regulation Department are also currently involved in assisting in several non-public investigations involving allegations of organized crime involvement, but is unable to comment on these confidential matters.

Although CPAG has had extensive involvement in assisting prosecutors and agents on organized crime-related cases, this is a relatively small part of that unit's work. Of the approximately 200 matters CPAG has assisted on, fewer than a dozen have involved any allegations of organized crime involvement. The non-Mob cases have in fact often involved more defendants and, in some cases, more extensive securities frauds than the Mob-related cases.

For example, CPAG is currently assisting the U.S Attorney for the Southern District of New York on *U.S. v. Randy Pace, et al.*, a case involving numerous fraudulent initial public offerings, primarily involving a notorious penny stock firm named Sterling Foster. NASD Regulation brought a major regulatory action against Sterling Foster and its principals and brokers in 1996, an action that preceded SEC and criminal charges. CPAG has spent many months analyzing the trading records of the securities involved in the criminal case. On September 8, 2000, the two primary defendants in that case—Randy Pace and Warren Schreiber (pleaded guilty to criminal charges that they helped cheat investors of $170 million by manipulating the price of stocks the firm underwrote.

In *U.S. v. Swan, et al*, CPAG's Chief Counsel, also supported by the Market Regulation Department, was the lead prosecutor in a series of related cases in Las Vegas in which thirty-eight defendants, including stock promoters, stockbrokers, financial public relations consultants, officers and directors of the public company, and the company's accountant, pleaded guilty or were convicted at two trials on charges including racketeering, conspiracy, securities fraud, wire fraud, money-laundering, illegal structuring of financial transactions, and tax evasion. In essence, the Chairman and CEO of a company named Teletek recruited a nationwide network of stockbrokers and bribed them to recommend Teletek stock to their customers, often by

sending thousands of dollars in cash by Federal Express. The most culpable of these defendants are facing likely sentences of approximately 10-14 years in prison.

CPAG has also provided assistance to the Manhattan District Attorney's Office in *People v. Victor Wang, et al.*, an indictment issued on May 5, 1999, charging 17 defendants with 109 counts of Enterprise Corruption, Grand Larceny, violations of the Martin Act, and related charges at Duke & Company. This case grew out of an independent NASD Regulation investigation that was ultimately referred to the prosecutors.

More recently, CPAG assisted the Manhattan District Attorney's Office in a case involving allegations of manipulation of numerous stocks over a nine-year period by the brokerage firm D.H. Blair. This case was preceded by an independent NASD Regulation action in 1997, in which D.H. Blair was fined $2 million and ordered to pay $2.4 million in restitution to customers.

Just as a small part of CPAG's work involves organized crime, it also makes up a small part of the work of the Market Regulation Department. Market Regulation has also assisted prosecutors in referring investigations of insider trading and fraud to the SEC and criminal law enforcement agencies around the country. These referrals resulted in numerous criminal cases filed. Market Regulation has been particularly active in surveilling fraudulent Internet activity, particularly so-called "pump and dump" schemes. Two examples of our ability to act quickly are cases involving Uniprime Capital and NEI Web World, both over-the-counter micro cap companies.

In the Uniprime case, the issuer claimed in press releases that it had developed a cure for AIDS. This information combined with Internet message board chat spurred investors' interest, causing a 300% price rise in Uniprime shares and over $20 million in market transactions. This scenario was identified immediately and referred within the same day to the SEC and U.S. Attorney's Office. This referral resulted in the SEC taking civil action and the U.S. Postal Inspector service arresting the architect of the scheme, a paroled convicted murderer. The U.S. Attorney's office for the Southern District of New York is currently prosecuting this case as *U.S. v. Flores.*

In the NEI Web World case, Internet message board activity containing false merger information caused investors to purchase NEI Web World shares, driving the share price from $0.09 to over $15 in less than an hour of trading. Again, this scenario was identified immediately and referred the same day to the SEC. This referral resulted in the SEC taking civil action and the FBI arresting three recently graduated UCLA students for perpetrating this scheme in which they dumped previously purchased NEI Web World shares into the rising market created by their fraudulent Internet postings.

NASDR's Taping Rule

When NASDR succeeds in putting a securities firm out of business, our job is not over. Sometimes the principals in those firms turn around and form new firms under a different name; other times the brokers go in clusters or *en masse* to a new firm or to existing broker-dealers. When a large number of these brokers become employed at another broker-dealer, this raises the risk that their new firm will have significant sales staff that may have taken their bad habits with them.

In September 1997, NASDR filed with the SEC a significant new rule proposal on the taping of broker's conversations with their customers. After comment and approval by the SEC, Conduct Rule 3010(b)(2) went into effect on August 17, 1999. The rule requires a brokerage firm to tape record all brokers' calls with existing or potential customers if a certain percentage of the firm's brokers were employed by firms that have been expelled or had their registration revoked due to sales practice violations. The numerical criteria vary, depending on the size of the firm. The threshold percentage of brokers from a "disciplined firm" that would require recording ranges from 40% for a small firm to 20% for a large firm. Once a member becomes subject to the Taping Rule, it must not only tape telephone calls for two years, it must establish, maintain and enforce special written procedures to supervise the telemarketing activities of all of its registered persons.

Training

NASD Regulation has also been very active in providing training on securities issues to prosecutors and investigating agencies. In each of the last three years, the FBI has held a week-long training program on securities cases at its facility in Quantico, Virginia; CPAG and NASDR's Market Regulation Department have taught agents as part of this program every year.

On September 26-28, 2000, CPAG's Chief Counsel will be one of the instructors at the Department of Justice's Securities Fraud Seminar at the government's training facility in Columbia, South Carolina. This seminar is being given to approxi-

mately 70 Assistant United States Attorneys from offices throughout the country. Market Regulation staff regularly take part in SEC training to develop investigative techniques and inform staff of tools available through NASDR. Representatives of NASDR's Enforcement Department frequently provide training to prosecutors and agents, including recent sessions in Boston, Miami, and San Francisco. NASDR's New York district office regularly provides various levels of training to agents and prosecutors, including intensive programs in which FBI agents, federal prosecutors, and prosecutors from the New York Attorney General's Office and the Manhattan District Attorney's Office spend two to three full days learning how the securities industry is structured, how NASDR conducts its examinations of brokerage firms, and how to understand the various records maintained by brokerage firms and NASDR, among other topics. In addition, that office coordinates quarterly meetings with Federal, state and local prosecutors in the New York City area that include discussion of identification of the influence of organized crime. NASDR has also provided training for foreign securities regulators on a number of occasions.

CONCLUSION

In closing, I wish to emphasize that the NASD is committed to providing a fair, well-regulated environment for the trading of all securities, even the most thinly-traded stocks, free of the taint of organized crime. We promise to continue to work diligently with federal and state law enforcement towards that end. Thank you.

Mr. OXLEY. Thank you, Mr. Goldsmith.

And thanks to all of our panel.

We now go to recognize Mr. Fuentes of the FBI, who has a presentation of some tapes that were obtained in the investigation of a particular case. Again, I would admonish the members of the audience as well as the media that some of these tapes are rather graphic and off-color, to say the least. The Chair thinks that as based on getting a real flavor for what these folks are involved in, that it would be appropriate and the media can make their own editorial judgments as to what, if anything, to redact or delete.

With that, Mr. Fuentes of the FBI.

Mr. FUENTES. Thank you, Mr. Chairman. These tapes in summary——

Mr. OXLEY. Get your mike closer.

Mr. FUENTES. Thank you, Mr. Chairman.

In summary, these tapes were made in 1997 pursuant to the Mob stocks investigation, and what you will hear are members and associates of organized crime, and promoters of the stock, and the CEO from the Healthtec Company discussing basically the scheme of pumping up the stock. And later when the coconspirators stop trusting each other, rather graphically they try to persuade each other to continue the scheme and not start pulling their money out early. And when that falls apart, they begin to make disparaging remarks about each other in very graphic terms.

In any event, these tapes were evidence. They were obtained pursuant to court-ordered electronic surveillance; therefore, they are not edited in any way or form, and they were provided to the defendants pursuant to discovery in that prosecution. So these are the raw tapes made during the wiretaps in that case.

Mr. OXLEY. For the record, this case now is completed?

Mr. FUENTES. Yes. These defendants were convicted. They pled guilty in this case, but nevertheless the tapes and all the electronic surveillance conducted during the investigation was provided to all defendants during the discovery process in that prosecution.

Mr. OXLEY. Thank you.

Let me yield to the gentlemen from Maryland for a question.

Mr. EHRLICH. This went to trial and these tapes were used as evidence at trial?

Mr. FUENTES. The defendants pled guilty. The tapes were provided to the defendants. It became part of public record. The transcripts and the tape recordings themselves were provided to all defendants that were intercepted or prosecuted.

Mr. EHRLICH. Thank you.

Mr. OXLEY. Staff can roll tape.

[Tape recording played.]

Mr. OXLEY. Thank you, Agent Fuentes, for that most interesting tape in Realism 101, I guess.

Let me recognize myself for beginning a series of questions.

In your estimation, what—is it possible to prosecute a case like this without the use of electronic surveillance?

Mr. FUENTES. We don't believe so. We think that the electronic surveillance is the most effective tool, as well as the use of undercover operations where possible, because it enables us to identify all of conspirators and not have to rely on just one of these individuals later being the basis of our prosecution. As you can hear, at some point in this proceeding they did not trust each other. They began to threaten each other and pull their money out of the scheme. And if we didn't have electronic surveillance, one of the individuals we just heard would have to be a witness and testify against the other individuals, and, of course, would lack the credibility in many cases to be effective in front of a jury.

The other aspect is—it is very difficult—as you can hear, if you are confused by the nature of these transactions, everyone is. These are very difficult cases to understand exactly how they are doing it and then to be able to educate a jury into exactly what occurred, how the scheme was set up by the subjects, how they actually make money in the scheme, how they threaten violence and other methods of extortion to carry this out. And these are very complex cases to do, and we believe electronic surveillance is critical in being able to do it.

Mr. OXLEY. I wonder if you could take us through a situation where you start with probable cause and are able to have a court order. The reason I ask you this is because the Judiciary Committee is considering changing the standard from what it is now, which is probable cause, to the—to a crime is going to be committed or has been committed. That is changing that standard rather substantially. Hopefully that bill will go no place, but it is interesting that that issue has come up, and particularly in this context, because my guess is that knowing the complicated nature, as you pointed out, it would be very, very difficult to go into a magistrate or a Federal judge and say with any degree of certainty and specification what kind of crime was being committed or about to be committed.

So I wonder if you could take us through what investigators are faced with in terms of getting approval up and down the line for that legal wiretap.

Mr. FUENTES. Well, the reason we believe that the standard is extremely strict, and justifiably so, but strict enough, is that we have to show that the telephone, if it is going to be the instrument of interception, or the office is being used to further the crime, and

that no other investigative technique will work; that if we subpoena individuals before the grand jury, they are likely to lie, they are likely to intimidate witnesses into either forgetting or not wanting to offer truthful testimony; other methods of surveillance will not identify all of the subjects of the conspiracy and all of the complexities of how the financial scheme is unfolding. We have to prove that all of these have been attempted and failed and will continue to fail without electronic surveillance.

Mr. OXLEY. Let me back up a little bit. And that is one of the bases for the affidavit that is filed with the Federal court?

Mr. FUENTES. Yes, it is. We refer to that as requisite necessity. In other words, it is the tool of last resort. Nothing else will be successful. It is the only option we have left, we believe, to successfully identify all of the subjects involved in the conspiracy, to obtain evidence that will support a successful prosecution at the end of the conspiracy and further the investigation, and that no other technique will enable that to happen.

Mr. OXLEY. So you have to show that, and you have to show that is probable cause that a crime is being committed.

Mr. FUENTES. Yes.

Mr. OXLEY. That is basically an affidavit by an FBI agent that goes to the Federal court, correct?

Mr. FUENTES. Correct.

Mr. OXLEY. But now it is not that easy, is it? In other words, you have to—from the time the agent is involved in the case, let me—take us through the bureaucratic maze that you have to go through with the Bureau and with the Justice Department before you even get to a Federal court.

Mr. FUENTES. Well, in the beginning it would entail the debriefing of informants, witnesses, citizens, individuals knowledgable of the industry involved; obtaining a tremendous amount of information as to what the conspiracy is about; and then later becoming specific as to where those conversations occur, whether they are occurring on the street corner as we see in organized crime when they do the so-called "walk talk," when they are walking around the block, or whether it is occurring in a vehicle or in an office or over office or cellular telephones. We have to show that we have probable cause that not only are they engaged in the crime and probable cause as to what specific crimes are involved, what individuals are involved, but specifically how they are talking to each other, where these conversations occur, and that we have reason to believe that a particular telephone or a particular microphone at a certain location will be the only way to capture those conversations.

Mr. OXLEY. Okay. Now, if you are an agent working on that case, and you have put that together in affidavit form, working, I assume, with your supervisor, correct me if I am wrong, how this works, the agent works with the supervisor; the supervisor basically okays the information in the affidavit.

Mr. FUENTES. Right.

Mr. OXLEY. Then does it go to the SEC, does it go directly to Justice? What is the next step?

Mr. FUENTES. During the first step this would always be a team effort because it is so labor-intensive on the part of the investigators and the analysts who are involved in the investigation. But the

team of agents and the case agent would prepare the affidavit. It would also be prepared in consultation with the prosecutor of the case, the assistant United States attorney assigned to the investigation. These are also partnerships with our counterpart strike force attorneys.

While the affidavit is being prepared, it would be reviewed by the supervisor of that squad, the assistant in charge of that field office as well as supervisory staff at the U.S. Attorney's Office, because we have to show not only that this is the way to gather the evidence, but that the result will be worth all of the resources, because other things will stop while this occurs.

Normally this would require an entire squad of agents and maybe assistance from a number of squads of agents for a long period of time. And so while that happens, individual management staff will have to determine whether this will be worth the resource expenditure.

In addition, it would be going through the legal review, that there is sufficient probable cause, that all the legal requirements and constitutional safeguards will be met while this is being prepared.

Now, these affidavits can vary anywhere from 40 pages to 140 pages typically, but will identify who will be intercepted, who are the conspirators, what the violations are, and the reason or basis for knowing that those conversations will occur either at a particular location or over a particular device or by e-mail, if that is the method of communication.

Once it has gone through all of the field office review and all of the review in that United States Attorney's Office for that district, in coordination with supervisors in my section at FBI headquarters and strike force supervisors from the Department of Justice, then the affidavit would be submitted to our headquarters and simultaneously to the Department of Justice.

Within the FBI I have the signing authority for electronic surveillance in these matters unless it is at a higher degree of sensitivity. Depending on where the microphone will be placed, it might require the Director of the FBI to personally authorize it. But for the vast majority of these type of investigations, I would sign at FBI headquarters for the authority to do it. My counterpart at the Department of Justice would also sign, and then once those two signatures and authorizations are obtained, then the case agent takes the affidavit with the order that has been prepared to intercept the conversations to the chief judge of that circuit, and then the judge would issue the order to conduct the surveillance and then would also set the order for continued reporting on the part of the agents and the prosecutor as the wiretap occurs.

These authorities are in 30-day maximum increments with reviews generally each 10 days where we would submit to the court how many conversations have been intercepted; have we intercepted the individuals that we said we would intercept; what evidence has been obtained to date; do we recommend or seek continued authority to conduct that surveillance. And generally, again, in a case like this, these surveillances will only go long enough—because they are so resources-intensive and so intrusive, they will only go long enough for us to gain the evidence we need for a suc-

cessful prosecution, and then, again, the team will determine at what point that will be.

One of the difficulties in these types of investigations is that while we are gathering that evidence, individual investors are losing money, people are becoming victims on a daily basis. And we have to balance the potential threat to those victims with the greater good of trying to stop all of these individuals, because we have learned from past experience if the case isn't pursued to its logical conclusion, they will jump to another firm, reform another company and start all over again the next day. Then we will go back to the beginning, trying to conduct surveillance, and talk to informants and start the process over.

Mr. OXLEY. Thank you.

Mr. Walker, do you have a comment on the electronic surveillance issue?

Mr. WALKER. Only that it is vitally important in this kind of a war. Civil regulators don't have that kind of authority, nor do we have access to communications that are contained by the FBI. But certainly, even though it is not available to us in the short run, the long-term value to us of being able to get that kind of evidence is significant. Even if we do not know what the substance of the communications is, we can assist criminal prosecutors in bringing cases through other means. We can help explain how the markets operate, how they work, provide technical expertise and also provide assistance in terms of helping people prosecute the cases.

But the fundamental evidence-gathering process is very, very important to these kinds of cases.

Mr. OXLEY. I appreciate that. There is a great misconception, I think, out in the public, and certainly here on Capitol Hill, in some quarters, that electronic surveillance, A, is always bad and, B, is unconstitutional and violates the individual's rights.

And the reason I wanted you to go through this whole process was to indicate how difficult it is to investigate these cases and how difficult it is to get approval from a court for wiretaps or bugs in the nature of the investigation. And it is something I think that the public needs to understand a little better, particularly as we enter into the new world of digital communications and the obvious difficulty it may present to law enforcement in terms of intercepting that kind of information.

So I thank you both. I have gone well beyond my time.

Let me recognize the gentleman from Wisconsin, Mr. Barrett.

Mr. BARRETT. Thank you, Mr. Chairman. Thank you for holding this hearing.

As a layperson, it is fascinating to listen to the tapes. Salty as it may be, I think it certainly is the color of what is going on out there. And my first question is—and any of you can answer—how widespread do you see this problem?

Mr. WALKER. I guess from a securities regulator point of view—I am Richard Walker from the SEC—we have seen an increase in this kind of activity, to be sure. I think it corresponds with the growth of our markets and the bull market which has extended over 10 years. I think over the last 3 years there have been nine large, major cases that have been brought that netted 30 people specifically identified as members of organized crime.

At the same time, I don't believe that there is cause for alarm in terms of the overall integrity and fairness of our markets. They are terrific. They are fair and they will continue to be fair.

Most of this activity occupies what some might call a dark corner of the market. A market involving low-priced, thinly traded securities that aren't subject to some of the same regulations as exist in other parts of the market. It is an area where we have to spend very close and careful attention to make sure that this kind of activity is carefully monitored.

I think we have had some enormous successes, and I think that future successes will build on existing cases.

We had one very large undercover operation that we worked on with the FBI, which was hatched back in 1996, that resulted in over 100 cases. Predictably, those hundred cases have led to leads in other cases. And the cases that were announced this past June—there were 120 indictments handed up in the Southern District of New York, and the SEC brought a number of cases as well—have been a fertile pot of leads and evidence to make future cases.

I think we have had some terrific successes, and we anticipate continuing very vigorous law enforcement in this area.

Mr. BARRETT. As an investor, a small investor, are there things that I should be looking for or other small investors should be looking for? Obviously, you indicate penny stocks that are seldom traded. Are there certain things out there that Joe Blow should be concerned about?

Mr. WALKER. Certainly in the penny stock and the low-priced arena there is often less information available to small investors, which means that greater care has to be exercised. Investors have to do more homework before they put their money in that kind of a stock.

There is a lot of help investors can get. Certainly we have a very full Web site which gives tips to investors. That is available to anybody. The State securities regulators and the NASD also have a lot of help that they can provide to investors that have questions about investing. And we always encourage and hope that investors will avail themselves of those resources.

Mr. GOLDSMITH. If I might add one comment, I think that some of the pitches you might see, whether it is organized crime, regular crime or just garden variety securities fraud that investors need to be aware of are promises of guaranteed returns, doubling, tripling your money in a short period of time. And I think Dick mentioned this, that in this type of bull market with more and more new investors and investors having the expectation of quick profits, 100, 200 percent returns on their money, that investors need to be very careful when anyone over the telephone, over the Internet, in person, whatever, makes those kind of promises.

And I think the regulators need to continue to work and do an even better job of educating investors, because it is much harder to get the money back to people after it is taken than to have them protect themselves at the outset.

Mr. SKOLNIK. Congressman Barrett, one of the common themes we observed in connection with a lot of the microcap fraud over the past decade is that these stocks were sold in large part by high pressure phone sales solicitation campaigns. And we at that level

routinely urge investors to be very careful before they invest with strangers over the telephone.

Mr. BARRETT. Are they hitting the elderly, or who is their market?

Mr. SKOLNIK. It was not confined solely on the elderly. Understandably, the elderly are oftentimes targets of scam artists and con men, but we have witnessed situations where rather sophisticated, knowledgeable businessmen and women and professionals have been targeted by these microcap firms. In fact, many of them worked off of leads they had obtained from lists of small business owners and the like who oftentimes will have some income that they can utilize to invest in the market.

So this is not solely confined just to senior citizens or the elderly. To a large degree, we are all potentially vulnerable to this type of activity.

Mr. BARRETT. Mr. Fuentes, after listening to that tape, what was going through my mind was, how do you initially come onto these guys? How do you find out that they are up to no good? Is it something you see in the stock or something you hear on the street? What is sort of the general area that you can say there is something going on?

Mr. FUENTES. It would come from both—we have in—many times getting referrals from our regulatory agencies, from the SEC, informing us that they are observing something that is unusual—which these days is harder to tell, because I guess there are so many amateur investors on line that it is harder to tell when stocks start changing hands, whether some other factor is at play that may be legal, but just misguided investment transactions.

But I would like to add that we have had a very aggressive, and we believe successful penetration of the American la Cosa Nostra over the last 20 years in our organized crime program; and in connection with that, as was mentioned, ''The Sopranos,'' many of them now sing for us. And a number of our cases have begun because we have gotten information from someone we have developed as a confidential informant, a cooperative witness, a cooperative defendant who is informing us of a given scheme and identifying who the individuals are and generally identifying how the crime is being committed.

So I would say at this point that probably about half of our case initiations are based on informant information as a result of our intelligence base within the crime families as to what they are looking at as new money-making opportunities.

But additionally our partnership has been very, very good with the other agencies; and as I mentioned, the SEC is coming with us and being part of these joint investigations, and then they spawn leads. And many of investigations are part of prior investigations or identifying subjects that we know to be identified as criminals. And if they switch to another company, we know they will not suddenly become legitimate in most cases and go from there.

I would like to add also, in terms of the warning signs, many of these warning signs are the same in this industry as in any other fraud arena. So we have always had people selling swampland in Florida. Now we have people selling stock in companies that have swampland in Florida. So it is still the same thing. If the scheme

sounds too good to be true, if they are guaranteeing that you are going to make a huge amount of money on a minimal investment, chances are it is too good to be true.

What has happened though in the last year or 2 under the bull market, particularly with the dot.com IPOs, the word in the media that individuals were attending class in college 1 day and were multimillionaires the next as a result of various offerings, I think that contributes to people thinking they can do it also, that they can get on line without guidance, without seeking professional assistance or without doing research or due diligence into whether a company really is making what it says it is going to make or providing a service that it says it is providing.

So the opportunities for fraud really are the same as they have always been, except in this area. Now, with the increase in amateur on-line trading, the opportunities for organized crime or other criminals who may not be part of organized crime to find victims, we believe, has just increased exponentially as people are on line.

Mr. OXLEY. The gentleman's time has expired.

The Chair will recognize Mr. Shimkus, the gentleman from Illinois.

Mr. SHIMKUS. Thank you, Mr. Chairman.

All these phrases come to mind: "Oh, what a tangled web we weave when first we practice to deceive"; "No free lunch"; "Let the buyer beware." And there is in traditional investments in the stock market, the basic premise that the higher the return, the bigger the risk. And I guess nowhere else is that more true than in these schemes.

People need to realize that, especially as amateurs are getting into the market. They only get a big return if there is a big risk, but they also can lose a lot. This only adds to it, with the corruption.

I don't know if we can do this, but Mr. Skolnik, you had that flow chart of the organization. Mr. Fuentes, these two guys that we have the tape on, Mr. Lombardo and Mr. Hall, where would they be in that chart?

I know I am talking to two different agencies and I understand that. Based upon that, where do you think they are? Where are they located somewhere in there?

Mr. FUENTES. I apologize for not having seen the chart before.

Mr. SHIMKUS. I know it is a tough question.

Mr. SKOLNIK. Let me emphasize, this chart is just a snapshot of——

Mr. SHIMKUS. Organized crime?

Mr. SKOLNIK. Yes, a network.

Mr. SHIMKUS. We are basically saying, since we have a broker and a CEO, that they are probably at least the third or fourth level down in that chart of organized crime.

Mr. SKOLNIK. What this chart illustrated was really the flow of agents who had ties with one firm or had been employed by one firm. They moved on to a new generation of firms in which many of them became principals or played a leadership role in the new firm. This is where we began to discover that there was a real network that existed out here.

In many instances, some of these firms were closed down through the good work of Federal and State regulators. But the agents kind of scattered like—as one of my colleagues said, like cockroaches, and formed alliances with these new firms. And many of these agents could not have become principals at the second or third generation of firms, frankly, without some type of backing from some place, because many of them did not have the financial wherewithal or even experience in the industry, but they were able to set up shop elsewhere.

This is just a snapshot of some firms in which we determined a linkage, many of them to Stratton Oakmont, which is one of the most notorious microcap firms that existed back in the mid-1990's. It is certainly by no means exclusive, and there are many other firms which have been discussed today in testimony that are not reflected on this chart.

Mr. WALKER. In fact, on the tape that was played, Mr. Lombardo had infiltrated another firm called Meyers, Pollock, which is now defunct. He was operating on the sell side, if you will. He was in charge of manipulating the price upwards and selling it out at a retail level.

Mr. Hall, who I don't believe was identified as a member of an organized crime family, was behind the issuer. He was trying to have the broker/dealer manipulate the price of the stock to make money.

Mr. SHIMKUS. Thank you.

We, not only on this committee but my other Subcommittee on Telecommunications, with the chairman and his background, have been at odds on some of the electronic surveillance issues that we have had on that committee.

Had that conversation been over the Internet, would we still have access to transcripts of that conversation?

Mr. FUENTES. Depending on the encryption, probably not.

Mr. SHIMKUS. That also goes for real time? Now we have real-time Internet transactions?

Mr. FUENTES. Yes.

Mr. SHIMKUS. What about digital phones? What if it was from cell phone to cell phone, both digital?

Mr. FUENTES. That part can be done either way, the digital, but it depends on whether it is an encrypted system, which most of the e-mails will have some sufficient encryption to prevent that.

I would like to also add that the difficulty with e-mail is that you really do not hear the tone of voice. You can't tell in the person is screaming or——

Mr. SHIMKUS. Unless there are exclamation points and frowny faces.

Mr. FUENTES. It helps to hear the tone of voice in trying to determine, are they saying this tongue in cheek? Does he really mean it? Is he really going to fly to Arizona and kill somebody and kill his wife, hold him hostage? Is he kidding?

Does the other person at the other end show fear in that conversation so that we can say they are using intimidation and threats of violence, and that it is serious?

You can hear these kinds of conversations, you know, in the locker room at your health club and the people do not really mean it.

They are getting ready for a tennis game or something. But in our cases, they mean it more often than not, and that is the part that is conveyed through the telephone or through microphone interception that e-mail interception will never substitute for.

Mr. SHIMKUS. And do you accept the premise that even if—that encryption technology is readily available to be downloaded even overseas to be used?

Mr. FUENTES. Yes.

Mr. SHIMKUS. I know my time is up, Mr. Chairman, but if I could just finish up.

We focus on the microcap market for the most part. How do we, without closing down that market, because it is valuable to the small, emerging companies, how—what type of—what is the recommendation from the panelists here on how we can help, other than the "buyer beware"—and you all mentioned it. What institutionally can we do?

Mr. GOLDSMITH. I think that is a very good point.

There are many legitimate small firms and business persons looking to raise capital. Where I think we have seen most of the problems has been on the over-the-counter bulletin board and the pink sheets. We received approval from the SEC last year to implement a new rule on the over-the-counter bulletin board that, for the first time, would require companies whose shares are quoted there to file periodic and current financial reports with the SEC, so at least investors have some source of information about these companies.

I think investor education and due diligence is a theme we have heard from everybody today. And there are many, many good companies out there whose shares at one time were traded and could be viewed as thinly capitalized and have gone and grown into good companies. But I think rules like our bulletin board rules and encouraging investors to get the information they need before they invest is probably the best way of accomplishing that.

Mr. SHIMKUS. Does anybody else want to add to that?

Mr. Walker.

Mr. WALKER I agree completely with what Mr. Goldsmith said.

I think one of the other things that we tried to do is recognize that every manipulation begins with a manipulator getting a cheap and large supply of stock. Manipulators obtain this stock basically for pennies or for almost nothing. And again it is important that small companies be able to sell stock to raise money to grow their businesses, but there have to be some safeguards so that this kind of situation doesn't occur.

And what we have tried to do is look at some of our capital-raising tools, and without unduly hindering the small businesses, add some disclosure features so that people will be able to identify where this small stock came from.

If it is restricted stock, we seek to have be known as well. These steps are designed to stop the bad guys from too easily getting large blocks of stock, pumping it up, and unloading it on the public.

Mr. SHIMKUS. Mr. Skolnik.

Mr. SKOLNIK. Congressman, in addition to strong enforcement, which I outlined in my remarks today, I think we need to emphasize the importance of investor education. I believe a well-educated

investor is ultimately the best weapon against securities fraud. And at the State level we have really elevated investor education within NASAA; for the first time ever we now have an Investor Education Section.

I think that is an important role that regulators need to play, and I think we are beginning to play, is to help investors arm themselves with the tools they need to make sound decisions.

Mr. SHIMKUS. Thank you. Fascinating testimony. I appreciate your time.

Mr. Chairman, I yield back.

Mr. OXLEY. Thank you. The gentleman's time has expired.

Mr. Largent, the gentleman from Oklahoma.

Mr. LARGENT. Thank you, Mr. Chairman.

I am embarrassed to say I saw the movie "Boiler Room." I think that was the name of it. Did anybody see that movie, any of our witnesses? It was a terrible movie.

Mr. OXLEY. Are you the Gene Shalit check of the Commerce Committee?

Mr. LARGENT. Two thumbs down.

Is that actually a somewhat good portrayal of what is taking place?

Mr. WALKER. I think in some respects it is an accurate portrayal of some aspects of how classic boiler rooms operated. Certainly a number of the firms that we have identified and taken action against, have large numbers of people manning telephone banks, making calls to potential investors, selling swamplands in Florida or making other false promises about companies.

There is a lot of high pressure activity in those kinds of firms, and the hallmark has always been that they have to be prepared to close down and move on quickly. And I think one of the scenes in the movie showed that they had rented a space close by, and it had the phone lines already installed, so that if the government arrived and shut them down, they had a new place to go and move in very quickly.

I do think that because of the enforcement efforts that have occurred over the last 5 years, and principally the strong involvement of the FBI and criminal law enforcement, the historic boiler rooms of the past aren't as likely to spring up in the future. I think people have found—which is a scary challenge to all of us—that the Internet now provides cheap, efficient and easy means of communicating with large numbers of people without the kind of overhead that traditional boiler rooms required. So our fear is that the challenge of the future is going to be policing some of this kind of activity as it migrates from the traditional boiler rooms of the past to the Internet of the future.

We have not seen the same kinds of large, 100-plus person boiler rooms sprout up in recent years in the aftermath of the efforts to shut down the firms that we have identified today. Though, having said that, I want to caution that there will always be firms that are telemarketers that engage in this type of activity, whether it is securities or other types of investments. This is something that is going to be a perennial problem.

Mr. LARGENT. Mr. Goldsmith, you talked about the new reporting requirements for financial reports for over-the-counter bulletin board companies. Are companies complying with that?

Mr. GOLDSMITH. That is an interesting question. About half of the companies that were quoted on the over-the-counter bulletin board at the time the rule went into effect have complied with that rule, and the others have now migrated off there to the pink sheets or who knows where. This is a first step for investors to have some information.

So we are hoping that the quality of the issuer will be enhanced by these rules, but many have decided, for whatever reason, not to comply.

Mr. LARGENT. I wanted to ask—Mr. Skolnik, in your testimony you said that the State security commissions are averaging about 300 criminal convictions per year. Could you give us an idea or breakdown of those convictions, based on the type of crime and which States have had the most convictions?

Mr. SKOLNIK. Let me clarify, that is an aggregate amount that States average across the country.

The convictions oftentimes, I think, arise from what I would refer to as many so-called homegrown securities frauds. Oftentimes a corrupt broker or financial advisor in a community will bilk investors in that community, costing them maybe even millions of dollars. And that is oftentimes what will trigger a criminal investigation by prosecutors working with the State securities commission.

I don't have data regarding the number of convictions or actions that are filed on a State-by-State basis. Possibly we can provide that information to you. I will check with the office.

Mr. LARGENT. This says 300 convictions. How many cases were prosecuted?

Mr. SKOLNIK. Again, I don't have that number right now. I would assume some of those involve multiple convictions. There are probably hundreds of criminal cases that are filed annually throughout the country.

Mr. LARGENT. How many of those would you say involve organized crime?

Mr. SKOLNIK. Probably not as many as we really need to focus on.

As I indicated, I think a lot of them are directed—at least if the experience in my State is any indication, are directed really toward individuals who are based in that State. They may have ties to organized crime, but oftentimes not.

These are folks that have set up maybe storefront operations, that are in small towns—whether Indiana, Oklahoma or any State. And I think we need to do more in terms of working with State prosecutors that target some of the types of firms that we have discussed here today. Obviously it is very difficult, because these types of actions are very time consuming, very paper intensive and they oftentimes involve firms that are located many miles away from our jurisdictions.

Mr. LARGENT. Mr. Fuentes, would you have any information on that? If there are 300 convictions a year across the country, how many of those would you say involve organized crime?

Mr. FUENTES. I would have really no way to easily identify that.

But the other problem you would have in State and local statistics where they were reporting would be that in some cases you would have a conviction for fraud, but not necessarily a securities fraud. If it is violating Federal violations, it possibly would be referred up; and actual Federal statutes will be used, which regulate the securities industry.

So in some State cases you would have a regular financial fraud that might not rise up to be reported and tracked as this industry or involving directly the securities industry.

I would also like to add that one of the things that we see as changing and making this area extremely threatening over the future is, we have had a thorough penetration of la Cosa Nostra here from a variety of other prosecutions over the last decades. And we are able, usually early on if one of major crime families is involved, to identify that, because in organized crime, and particularly the Cosa Nostra, if someone comes up with some scheme that will make a lot of money, that immediately rises to their senior levels. So we hear about it at some point because the bosses and the capos are going to get involved in nurturing their golden goose who came up with this scheme to make money.

So we believe we have a pretty good handle on those types of crimes and have attacked that very thoroughly, as we talked about, in these prosecutions.

The difficulty now is, we have companies, in some cases based overseas with U.S. Subsidiaries, filing documentation in a variety of jurisdictions, U.S. And outside of the U.S., and have a tremendous difficulty in even verifying that that record keeping is accurate. When they have their audits from major accounting firms conducted overseas, it is difficult for us or U.S. Agencies to obtain that information or to be able to go behind the documents and verify that they are accurate and true and are actually depicting what operations that company has.

In the case of some of the groups we are seeing from the former Soviet Union and Eastern Europe, we have companies engaged in a business. It is not an entire shell organization or a complete fraud. They are engaged in some legitimate production of a product, but cooking their books, inflating their sales or their production capacity; and therefore, when they issue stock offerings on one of the exchanges in the world, they are able to fraudulently claim huge profits that don't exist and get people interested.

In the YBM case that I spoke of earlier, that company began trading in Alberta, Canada, at 18 cents a share. And a few short years later, with virtually no increase in production capacity, they are offering a $100 million offering on the Toronto Exchange, simultaneously with documents being filed here in the U.S. To issue offerings to U.S. Investors on NASDAQ.

On that situation we were luckily and fortunately, from very early in that case, involved in working jointly with the SEC in particular to stall that, to not respond to their request to issue that stock offering in the U.S., which enabled us to have enough time to conduct our wiretap investigation and obtain other evidence.

But we jointly, in that case, prevented a large investment fraud which would have occurred in the U.S. And we are not talking about the penny stocks any more. We are talking about multimil-

lions, in some cases $100 million offerings suddenly being put up there.

Mr. LARGENT. Thank you, Mr. Chairman.

Mr. OXLEY. The gentleman's time has expired.

Let me ask in regard to penalties. All of you have made a cogent point that the biggest deterrent is jail time.

What are the maximum penalties for this, and is the RICO statute the statute of choice in most cases in the prosecution of these? Let us begin with Mr. Fuentes.

Mr. FUENTES. Yes, we hope to obtain the evidence to support a RICO prosecution because the penalties are more substantial.

Mr. OXLEY. Most of the prosecutions so far have been under RICO?

Mr. FUENTES. Wherever possible, we have used the RICO statute to do it.

Mr. OXLEY. What is the difference in the maximums under RICO versus standard fraud statutes?

Mr. FUENTES. It could be the difference of 1 or 2 years' exposure for jail time in a case to 20 years, depending on the violation. It substantially increases the threat of prison sentences.

And I might add, the other aspect of it is the forfeiture provisions of the RICO statute and the damages of either civil RICO or criminal RICO proceedings against them.

One of the things I would like to add is that the FBI agrees that prison sentences are a strong deterrent and need to be there, but we will also add that organized crime exists for the financial aspect of it. It is to make money. And we have to have the means to take it away from them, once they have made it, and not be able to pass their wealth on or hide it with other members of their families, or friends, or move it offshore.

So we regard forfeiture in the other provisions of the RICO statute to be very important in these statutes.

Mr. OXLEY. The Judiciary Committee is looking at the forfeiture laws, and you make an excellent point regarding that. What about restitution? Is there any real chance that some of these people that get ripped off—whether it is organized crime or whether it is a run-of-the-mill crook or a broker gone bad, what are the ways that people can get at least some of their money back?

Mr. Goldsmith.

Mr. GOLDSMITH. Individually, and this is really without—the regulator, certainly can try to file arbitrations, which is very hard to do when a firm goes out of business or is put out of business.

The SEC does an excellent job of getting what money there is back to investors. Each year we return millions of dollars to investors. But where you see the large sums of money coming back really are from the criminal prosecutions. Once someone is facing jail time that is a very good incentive for somebody to suddenly find their bank account numbers offshore and bring back large amounts of money.

In many of these scams and frauds, the money is used up, high living styles, cost of doing business. So I really think if you are looking for the large dollars to come back, indicting someone, prosecuting them criminally, you see the money start coming in from offshore.

Mr. OXLEY. Mr. Skolnik.

Mr. SKOLNIK. I would concur with Mr. Goldsmith. We oftentimes tell investors that once you part with your money, it is oftentimes very difficult to recoup any loses that occur. Certainly when attempting to bring civil or administrative actions against some of these worst players or actors on Wall Street, the likelihood of State regulators recovering money is limited.

We too have found that criminal action is what—as Mr. Goldsmith said, is oftentimes what leads people to rediscover that they had offshore accounts.

Having said that, State securities regulators have been successful in any given year of recouping and recovering many millions of dollars for investors. However, that is really just a small percentage of the amount of losses that are out there.

Mr. OXLEY. Mr. Fuentes, you talked about the fact, in one of those particular cases, there were the five New York families involved in one way or another; and also you mentioned a Eurasian Mob as well as Russian. Specifically, as to the issue of Russian organized crime and the Eurasian, do they tend to prey on their own ethnic group within the United States or, in other words, do you have the Russian Mob basically focusing in on the Russian-American community in parts of New York?

Mr. FUENTES. We had that initially in the early phases of our crime problems with them. But these are a group of individuals who are three or four levels above the street thug level. So while we have Eurasian and Russian organized crime groups involved in street level racketeering, traditional racketeering acts of loan sharking, gambling and prostitution, we have another group of international criminals who are generally sitting outside the United States and penetrating the global financial network from afar; and that includes banking, as well as the securities industry.

These are the individuals that are the greatest threat, as we see it. They were the most difficult—they are very sophisticated. They are using multinational companies. In some of our cases, we are talking about investigations going on right now in a single case involving a single group in 35 countries. In our banking cases, it is even more because of the wire transfers of money around the globe.

So these are groups that are basically attacking our financial institutions from afar and this is why I spoke of the problem that in order to fight that, we need to be able to work with our foreign counterparts. We have the aspect of obtaining investigative results and evidence from other jurisdictions around the globe, hoping that they have the sophistication and integrity to provide that information for prosecution here. But it just adds to the difficulty of obtaining financial records to present in court in the U.S. Or in that jurisdiction to attack them.

Also it presents the problem—and I think this may be the greater problem in that when the audits occur, when the big six accounting firms and the other global firms are employed to examine their books, we have limited recourse in being able to go after them when they issue statements that those books are accurate.

So that even if you have due diligence on the part of a U.S. Investor, even an amateur investor, if they do their homework and try to learn about a company and see that a major accounting firm

has already examined that company and said their reporting is accurate, so they go ahead and make that investment, there will be limited recourse if, in fact, not only the original books of the company were fraudulent but the examination of those books was inaccurate or criminal itself. And that is what poses, I think, the greatest threat for us in the number of companies who are obtaining a financial interest in U.S companies, either a shell or an existing manufacturing company, just to have the opportunity to get on a stock exchange and trade here.

Mr. OXLEY. Mr. Walker, you mentioned in your testimony regarding the "pump and dump" schemes, that the SEC set up obstacles to that. Could you be more specific as to what those obstacles might be?

Mr. WALKER. Certainly. Every "pump and dump" begins with a manipulator acquiring cheaply a large supply of stock. One method in which this was done with some regularity was by issuing stock offshore for a low price pursuant to Regulation S, which is a safe harbor from the normal registration requirements. Within a short period of time, 40 days typically, the stock would come back into our markets. And this was a technique that we found was used very often in a number of cases and investigations.

So several years ago we changed the requirement of Regulation S to make it more difficult for that to happen. We lengthened the period of time that stock had to remain offshore before it could filter back into the United States. We made sure that it was viewed as restricted stock so that there would be restrictions upon its resale, which again would reduce its attractiveness as a pool of stock to be used in the manipulation.

We have also changed some of the requirements for unregistered offerings under Rule 504, which previously allowed any company to sell up to $1 million of securities without registering with the SEC; and we have now required that there can be no general solicitations under that provision.

These are two of the areas where we, I think, have had some success in limiting some of the fraudulent techniques that are used.

Mr. OXLEY. Thank you.

Mr. Skolnik, you had mentioned in your testimony that you would like to have the SEC be able to follow up on State enforcement actions. And I want to get Mr. Walker in on this as well. Would that require a change in the Federal statutes?

Mr. SKOLNIK. Yes, Mr. Chairman, it would. And it is my understanding that there is presently pending legislation that has been introduced—by Senators Collins and Cleland, I believe—that would allow the Securities and Exchange Commission to utilize a State action under certain circumstances as a basis for a follow-up action, if you will. We at the State level refer to that as piggy-backing. Oftentimes we will piggy-back on the action that has been taken in another State to suspend or revoke the license of a broker or a firm.

Mr. OXLEY. This would not be considered double jeopardy?

Mr. SKOLNIK. We are not talking a criminal type of actions. We are talking about utilization of administrative remedies.

I think—I concur that there would have to be some assurance that due process is followed. I would propose that the SEC only be

allowed to take this action after there was some assurance that there was a hearing and opportunity to be heard at the State level, as well as for a hearing possibly at the Federal level also.

Mr. WALKER. Though our agency has not taken a position on that particular provision, speaking as Enforcement Director, I am very interested in a provision that would allow us to take actions based on a substantial record provided by a State jurisdiction, if appropriate due process guarantees have been provided. It would be very useful to us to take the work that has already been done and use that as a basis for barring someone from participating in the industry.

Mr. OXLEY. Thank you.

Let me ask Mr. Goldsmith how is it that these folks can move from brokerage to brokerage virtually unimpeded. It is fascinating they can do this.

You are not alleging necessarily that these firms are not on the up and up? Some of these are reputable firms, are they not?

Mr. GOLDSMITH. I think, as an example, of the two individuals that we heard on the tape this morning, none of those people were registered with a brokerage firm. One was connected with the issuer and the other was controlling operations.

We have found that when we do put a firm out of business—when we, for example, expelled Stratton Oakmont at the end of 1996, it was a large firm and those firms scattered, the brokers scattered to other firms. We know where they are going; we focus our exams where they are going. If they have disciplinary histories or if they come from a firm that is expelled, our taping rule comes into place. But we really need to keep track of these people which we do.

I think the point needs to be made that, particularly in the organized crime area, where there are promoters, there are people connected with issuers, there are just the mobsters, that these people are not registered with us. They don't go through our registration process.

Mr. OXLEY. Thank you.

The Chair now recognizes the gentleman from Massachusetts for 5 minutes. We have a vote pending, as the gentleman from Massachusetts knows.

Mr. MARKEY. And I thank you. I appreciate your tolerance of my ability to be able to ask the questions right now.

Mr. Fuentes and Mr. Walker, if I may, in 1970 Congress enacted the Racketeer Influence and Corrupt Organizations Act, RICO, to help combat organized crime. RICO contains both civil and criminal enforcement provisions.

Now, the prepared testimony being presented here today indicates that the Federal Government has brought several criminal RICO prosecutions for Mob-controlled stock frauds. However, in 1995, the Republican-controlled Congress passed, over President Clinton's veto, the so-called Private Securities Litigation Reform Act that all but eliminated the use of civil RICO in securities fraud cases. In fact, under the 1995 act, there may be no RICO private civil action if the alleged wrongdoing is actionable as a securities fraud, regardless of whether a securities fraud action is brought and no matter how outrageous the contract.

As a result, the investors defrauded by Mob-influenced stock scams no longer can rely on RICO to go after criminal organizations for trebled damages, costs and attorneys fees.

Don't you think that we should restore, restate the ability of defrauded investors to sue Mob-influenced or -controlled stock scams, using the RICO statute?

Mr. Walker and Mr. Fuentes.

Mr. WALKER. Why don't I take a crack first, Congressman Markey. I am Richard Walker from the SEC.

Certainly we have always believed that private civil actions are an important supplement to what the government can do. I think, as we noted a little earlier, one of the real tragedies of these cases is too often, once investors part with their money, the money cannot be recovered even through the best of efforts. Oftentimes what we are looking at is a no-net-gain situation; and at the end of the day, despite the best efforts, criminal prosecutions, civil regulatory actions and private actions, the money has been spent and is gone.

But certainly we do, generally speaking, support the role of private parties and private civil litigants to seek to exercise their rights.

Mr. MARKEY. Do you agree with that, Mr. Fuentes?

Mr. FUENTES. Yes, I would agree with that.

Mr. MARKEY. Mr. Skolnik, during a debate over private securities litigation reform, the State securities regulators and State attorneys general opposed eliminating securities fraud as a predicate offense under RICO.

Does NASAA continue to believe this special exception should be repealed?

Mr. SKOLNIK. I don't know if NASAA has taken a position really on whether there should be any further modification or amendments to the civil RICO Act—to the Federal act. As I have indicated here today, I think if we are going to make a dent in fighting the Mob on Wall Street, we are going to have to bring—civil and administrative actions are not going to be sufficient. We will have to initiate more criminal actions because I think that is the only language that the Mob certainly understands.

I don't think NASAA has taken a position at this time regarding any proposals to the Federal act.

Mr. MARKEY. Can you, for the record, give us the position of NASAA, please?

Mr. SKOLNIK. Pardon?

Mr. MARKEY. Can you please, for the record, submit the position of NASAA on these issues?

Mr. SKOLNIK. On the question of?

Mr. MARKEY. Whether or not they support giving back this power to individuals.

Mr. SKOLNIK. As I sit here today I cannot, but certainly we can follow up on that.

Mr. MARKEY. That is what I am asking, for the record, please.

By the way, I think more and more Americans are becoming aware of this, because they are watching "The Sopranos," and they realize they are running an operation on the side, one of these boiler rooms. I think in their minds they can visualize how much people can be exploited by this.

And, in addition, I think you underestimate the strength of a defrauded investor, the anger that they would have.

Oftentimes, I actually find that prosecutors and police officials back away from the Mob, but an individual who feels aggrieved because their own family has been injured would be more likely to go out of their way to go after them.

So that is my own personal experience, and I think that more power to individuals might, in fact, help police, help prosecutors to take steps which they otherwise would be shying away from in a public policy context.

Mr. Chairman, I appreciate your indulgence, and I have other questions which I would like to submit to the witnesses for the record.

Mr. OXLEY. Without objection.

The Chair would also indicate, without objection the opening statements of all members will be made a part of the record.

Gentlemen, we thank you for your excellent testimony. This has been most enlightening for the committee, and we appreciate all of your participation.

The subcommittee stands adjourned. Thank you.

[Whereupon, at 12:20 p.m., the subcommittee was adjourned.]

[Additional material submitted for the record follows:]

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.
WASHINGTON, DC
October 20, 2000

The Honorable STEVE LARGENT
426 Cannon HOB
Washington, DC 20515

DEAR CONGRESSMAN LARGENT: During my appearance before the Finance and Hazardous Materials Subcommittee on September 13, 2000, you inquired about a breakdown of criminal convictions for securities violations on a state-by-state basis. I appreciate the opportunity to respond in writing.

Attached is a state-by-state chart of the securities criminal convictions for 1999. The total number of convictions for the 52 jurisdictions that responded is 307. Many of these convictions were obtained as a result of investigations launched by state securities regulators. I feel strongly that state securities regulators must work with their local prosecutors and pursue more criminal convictions so those who prey on innocent investors are put in jail.

We remain committed to working closely with prosecutors, law enforcement agencies, and regulators at both the federal and state level to protect investors from fraud and other types of securities laws violations.

Please don't hesitate to contact me at 317-232-6695 or Deborah Fischione, NASAA's Director of Policy at 202-737-0900 if you require further information.

Sincerely,

BRADLEY W. SKOLNIK
NASAA Past-President
Indiana Securities Commissioner

Enclosure

cc: Chairman Mike Oxley
Congressman Ed Towns

1999 SECURITIES CRIMINAL CONVICTIONS

ALABAMA	13
ALASKA	0
ARIZONA	10
ARKANSAS	1
CALIFORNIA	25
COLORADO	6
CONNECTICUT	2

1999 SECURITIES CRIMINAL CONVICTIONS—Continued

DELAWARE	0
DISTRICT OF COLUMBIA	0
FLORIDA	4
GEORGIA	12
HAWAII	1
IDAHO	3
ILLINOIS	6
INDIANA	6
IOWA	3
KANSAS	31
KENTUCKY	4
LOUISIANA	2
MAINE	10
MARYLAND	1
MASSACHUSETTS	1
MICHIGAN	3
MINNESOTA	9
MISSISSIPPI	2
MISSOURI	7
MONTANA	1
NEBRASKA	2
NEVADA	7
NEW HAMPSHIRE	1
NEW JERSEY	15
NEW MEXICO	0
NEW YORK	7
NORTH CAROLINA	6
NORTH DAKOTA	0
OHIO	6
OKLAHOMA	4
OREGON	5
PENNSYLVANIA	14
PUERTO RICO	0
RHODE ISLAND	0
SOUTH CAROLINA	0
SOUTH DAKOTA	2
TENNESSEE	2
TEXAS	37
UTAH	16
VERMONT	0
VIRGINIA	1
WASHINGTON	11
WEST VIRGINIA	0
WISCONSIN	7
WYOMING	1
TOTAL	307