U.S. Probes Alleged Scam In Brokers Test
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NEW YORK -- A federal grand jury in Brooklyn is investigating what could be a massive scam in which stockbrokers allegedly faked their way onto the National Association of Securities Dealers' list of registered brokers.

The scam allegedly involves would-be brokers arranging for other individuals to take a test, known as the "Series 7" exam. To be licensed as a broker by the NASD, one must pass the test, and those who buy and sell securities without a license are breaking the law.

The scope of the probe is unknown, but one individual familiar with the investigation said it will eventually touch every major brokerage firm on Wall Street.

So far, however, there is no indication that the probe has gone beyond a tiny band of brokers at two relatively small firms, Datek Securities Corp. of Brooklyn, and Brown, Knapp & Co. of New York.

Last month the U.S. attorney's office in Brooklyn filed a complaint that outlined the alleged scheme and named seven defendants, two of whom had allegedly taken the Series 7 exam for four brokers, Murray Huberfeld, Jacob Elbogen, Solomon Obstfeld and David Bodner. The seventh individual, Aaron Elbogen, allegedly served as a middleman, making the arrangements for someone to take the test for his brother, Jacob.

In 1987, Jacob Elbogen was one of a number of individuals who brought a securities class-action suit against a Cincinnati broker, P. David Herrlinger. Mr. Herrlinger then filed a third-party complaint against Dow Jones & Co., publisher of this newspaper. Mr. Elbogen later pulled out of the case against Mr. Herrlinger, who eventually dropped his claims against Dow Jones.

The NASD test complaint charges the defendants with conspiracy to commit securities fraud by filing false documents for obtaining membership in the NASD. Although they allegedly never took the test, Messrs. Huberfeld, Elbogen, Obstfeld and Bodner, the complaint states, "were licensed as registered representatives with the NASD and thereafter were employed by various securities brokerage firms, including Datek Securities and Brown & Knapp."

No other firms were named in the complaint, and a spokeswoman for the U.S. attorney's office in Brooklyn said she couldn't disclose whether any other brokers at other firms had been targets of the probe.

Calls to Datek Securities weren't returned, and no one could be reached at Brown Knapp. The defendants couldn't be reached for comment.

John J. Flood, the NASD's assistant general counsel, said, "NASD has cooperated fully with the Department of Justice, U.S. Postal Service and the U.S. attorney's office in connection with this and will continue to do so if requested to preserve the integrity of the examination process." He also said the NASD has been working with the New York Stock Exchange to develop a Series 7 exam that will "substantially reduce the exposure to many types of cheating."

All the defendants have been arrested and arraigned. An indictment is expected within the next six weeks, said an individual with knowledge of the probe.

The government's case in Brooklyn appears to depend heavily on handwriting analysis of the signatures on the test forms and the sign-in sheets at the NASD testing centers. A handwriting expert, the complaint states, indicated that Jacob Elbogen's signature on a sign-in roster for March 22, 1982, was written by another defendant, Joshua Wagshall, whose fingerprints were also found on the test forms.

Mr. Wagshall allegedly also took the test for Mr. Obstfeld on Aug. 22, 1983, and for Mr. Bodner on June 17, 1985. And on that same day, another defendant, Moishe Bodner, allegedly took the test for Mr. Huberfeld. The criminal complaint indicates that Mr. Wagshall has apparently cooperated with the government in its probe.

The NASD gives would-be brokers the opportunity to take the Series 7 exam every third Saturday each month at hundreds of test centers nationwide. In some cities, such as New York, the exam is also offered on the following Monday for those who can't take the exam on Saturday for religious reasons. The six-hour exam tests an individual's knowledge of the securities market as well as the laws and regulations that govern the market.

According to the NASD, nearly 50% of those who take the exam each year fail the first time. Most come back after failing the first time, following a 30-day waiting period. After the third failure, the applicant must wait six months to try again.

Last year, 46,223 individuals took the exam and 46.7% failed. As of January 1990, there were 6,148 broker-dealers in the U.S. and 438,701 registered brokers, according to the NASD.

Solomon Obstefeld was defendant in the National Heritage / ShaloamWeiss lawsuit with Eugene Grin. He also runs LH Financial which is named in the Sedona/Refco/Bawag case. The article doesn't say if he worked at Datek or Brown; Brown went out of business in 1987, and Datek was still a small firm in 1990.

Datek was pretty sketchy, and had links to Robert Brennan. It was also reportedly investigated for involvement with AR Baron. The principles ended up getting bared from the industry:

Online Brokers Fined Millions In Fraud Case
By DAVID BARBOZA
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Seven former traders and executives of Datek Online, a pioneer in online stock trading, agreed yesterday to pay $70 million in fines for what regulators called illegal trading and fraudulent bookkeeping during the market boom of the 1990's.

The Securities and Exchange Commission called it one of the largest securities fraud settlements ever.

Regulators said the group of former traders and executives made tens of millions of dollars from stock fraud that went on for nearly a decade and involved taking advantage of a Nasdaq trading system that was intended to help smaller investors.
Jeffrey A. Citron, 32, Datek's former chief executive, and Sheldon Maschler, 58, the former chief trader, agreed to the largest fines, $22.5 million and $29.2 million, respectively. They also agreed to be permanently barred from the securities industry. The others paid smaller fines and penalties.
Under the terms of the settlement, Mr. Citron and Mr. Maschler acknowledged no wrongdoing.
Regulators said the former Datek executives were caught taking advantage of a system that was set up to help smaller investors have their trades executed quickly.
"They always portrayed themselves as the little guy on Wall Street," said Marc Beauchamp, executive director of the North American Securities Administrators Association, which represents state securities regulators. "But apparently they were gaming the system for the benefit of a handful of Datek executives."
Mr. Citron and Mr. Maschler were instrumental in transforming Datek from a small day-trading operation in Brooklyn into one of the nation's fastest-growing online brokers in the late 1990's. They also helped create Island E.C.N., Datek's online stock trading network that once petitioned regulators to become a full-fledged stock exchange.
Datek, which long ago distanced itself from its former day-trading operation and was recently acquired by Ameritrade, paid a $6.3 million fine a year ago to regulators to settle similar accusations of stock fraud.
Mr. Maschler, now a real estate developer, was once seen as a day trader with a history of regulatory infractions and close ties to Robert E. Brennan, the former penny-stock promoter who is banned from the securities industry and is now serving a prison sentence for failing to disclose his assets.
Mr. Citron, who joined Datek at age 17, had a more polished image than Mr. Maschler had. A former trader, he was hailed in the late 1990's as "one of the 20 most important players on the financial Web" for blending computer and stock trading skills. In 1997, at 27, he was leading one of the nation's fastest-growing companies.
At the time, Mr. Citron was bold and confident. He was building a multimillion-dollar home on the Jersey Shore. He boasted of being worth more than $100 million. He owned a Gulfstream jet and often commuted to Manhattan by helicopter.
But his fall was swift. In 1998, after federal investigators began looking into accusations of illegal trading at Datek's former day-trading unit, it canceled plans for an initial offering. A year later, Mr. Citron quit as chief. In 2000, under pressure from some Datek investors and executives, Mr. Citron and Mr. Maschler sold their majority stake in Datek to private investors for about $500 million.
Mr. Citron is now the chief executive of Vonage, a telecommunications company. Last year, Fortune magazine listed him as one of the "40 richest under 40," with a net worth of $189 million.
Last year, Datek, then the nation's fourth-largest online broker was acquired by Ameritrade for about $1.3 billion in stock; the Island E.C.N. was acquired by the Instinet unit of Reuters for about $500 million.
A spokeswoman for Ameritrade said yesterday that it would not comment because the issues involved occurred before Ameritrade acquired Datek.

Datek rose to prominence by using sophisticated software to profit from making quick and aggressive Nasdaq trades.

But federal investigators say that during much of that time Datek executives manipulated the exchange's small-order execution system, which was set up to help smaller investors who had difficulty completing trades during the market crash of 1987.

Investigators say that Datek executives pretended to be using the system to make trades for smaller investors with accounts at Datek. In fact, they said, Datek's traders and principals were trading for their own benefit. At one point, regulators say, Datek accounted for about 30 percent of the trading volume on the Nasdaq small-order execution system.

To hide their involvement, investigators say, Datek executives recruited family members, friends and others to create so-called nominee accounts. Datek also created fictitious books and records and filed false reports with regulators, regulators say.

Later, some Datek executives set up a bank called Raft Investments and used about $50 million to finance some nominee accounts. Former Datek traders have said in interviews that they took out high-interest loans from Raft and that some nominee investors were guaranteed returns in exchange for the use of their names.

Federal investigators say most of Datek's trading profits went to Mr. Citron and Mr. Maschler and that fraudulent bookkeeping was used to transfer about $277 million to shell companies the two controlled. For instance, in 1995 and 1996, Datek sent $200 million to a company controlled by Mr. Citron. Investigators say that Datek fraudulently recorded it as a payment for computer services.

Datek's trading operation was so successful that by the late 1990's, the company had about 200 traders. Around 1997, however, it began transforming itself into an online brokerage firm that could be used by small investors.

Datek Online, as the company became known, helped usher in the era of cheap online trading and the $9.99 Internet trade.

But in 1998, when investigators began looking into accusations of illegal trading practices and money laundering, Datek sold its day-trading unit to Heartland Securities, a company controlled by Mr. Maschler and his son Erik.

Regulators say most of the nominee accounts were transferred to Heartland and the new company continued to engage in illegal trading as late as June 2001.

In a complaint filed yesterday in Federal District Court in Manhattan, regulators accused the former Datek employees of stock or bookkeeping fraud. They included Michael McCarty, 39; Aaron Elbogen, 54, the chief executive before Mr. Citron; and Moishe Zelcer, 56, the former chief compliance officer.

Erik Maschler, 32, who worked at Datek and Heartland; and Joshua M. Levine, 34, a former Datek executive and one of the chief architects of the Island E.C.N., were also accused of stock or bookkeeping fraud. Mr. Maschler has agreed to a $6 million fine and a permanent ban from the securities industry.

Mr. McCarty paid a $1.5 million fine; Mr. Elbogen paid $1.4 million; Mr. Levine, $1 million; and Mr. Zelcer, $150,000. Sheldon Maschler also agreed to pay a $2.3 million fine for improper investments involving a savings and loan.

In addition, Heartland agreed to pay a $7 million fine and be censured by the S.E.C.

Aaron Marcu, a lawyer for Heartland, said in a statement: "Heartland is very pleased to have resolved these issues and put it behind us."

Ted Wells, a lawyer representing Sheldon Maschler, but also the lead egotiator, said in a statement: "All involved are satisfied with the resolution of this case and, most importantly, are pleased to be able to put this matter behind them."