

# Testimony Concerning The Involvement of Organized Crime on Wall Street

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Committee on Commerce**

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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<sup>1</sup> 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 (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.<sup>2</sup> Indeed, there is evidence that organized crime had made inroads on Wall Street back in the 1970's.<sup>3</sup> Then, as now, organized crime reportedly focused its efforts on the manipulation of microcap stocks.<sup>4</sup>

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.<sup>5</sup> 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.<sup>6</sup>

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.<sup>7</sup> 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.<sup>8</sup> Co-defendant Formato testified in Congressional hearings that during the years he promoted and sold penny stocks, he was involved in organized crime.<sup>9</sup> Formato also testified to rampant penny stock manipulation by organized crime.<sup>10</sup> The Congressional hearings at which Formato testified led to passage of the Penny Stock Reform Act of 1990.<sup>11</sup>

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.<sup>12</sup>

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."<sup>13</sup> 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.<sup>14</sup>

Around the time of *The New York Times* story, *Business Week* also ran a cover story entitled, "The Mob on Wall Street."<sup>15</sup> 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.<sup>16</sup> 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.<sup>17</sup> 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.<sup>18</sup>

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, 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.<sup>19</sup> 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.<sup>20</sup> 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.<sup>21</sup>

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.<sup>22</sup>

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 stock on unsuspecting customers. Froncillo, as well as four other defendants, plead guilty to the charges.<sup>23</sup>

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.<sup>24</sup>

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 the murders, media reports have cited close ties between Chalem and organized crime.<sup>25</sup>

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 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:<sup>26</sup> 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. Goldman & Co.; A.S. Goldman's president, Anthony J. Marchiano and its financial and operations principal, Stuart E. Winkler; five A.S. Goldman 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.<sup>27</sup> 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.

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.<sup>28</sup>

**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.<sup>29</sup>

**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.<sup>30</sup>

**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.<sup>31</sup>

**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."<sup>32</sup> 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<sup>33</sup> 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"].<sup>34</sup> 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;<sup>35</sup> 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.

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## Footnotes

<sup>1</sup>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.

<sup>2</sup>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.").

<sup>3</sup>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 Aloï 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 Aloï, 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.").

<sup>4</sup>*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.").

<sup>5</sup>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.

<sup>6</sup>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.").

<sup>7</sup>*U.S. v. Zolp*, Lit. Rel. No. 11236, 1986 SEC LEXIS 635 (Oct. 2, 1986).

<sup>8</sup>"Securities Investigators Get a Handle on the Mob," *The Toronto Star*, Feb. 26, 1989 at F2.

<sup>9</sup>See "Witness Tells of Mob Influence in Penny Stocks", *Los Angeles Times*, Sept. 8, 1989 at B2.

<sup>10</sup>*Id.*

<sup>11</sup>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 customers, and provide a monthly statement to clients disclosing the market value of all penny stocks in their accounts.

<sup>12</sup>See Claire Poole, "Good-Bye, Fellas," *Forbes*, March 18, 1991 at 10 (stating that Fiorese had ties to the Gambino and Colombo crime families).

<sup>13</sup>Selwyn Raab, "Officials Say Mob is Shifting Crimes to New Industries," *The New York Times*, Feb. 10, 1997 at A1.

<sup>14</sup>*Id.*

<sup>15</sup>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.

<sup>16</sup>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).

<sup>17</sup>See Helen Peterson, "Mafioso Held in Stock Fraud," *N.Y. Daily News*, May 3, 1997 at 12. Malpeso pled guilty on February 5, 1998.

<sup>18</sup>Malpeso was sentenced to 18 months imprisonment.

<sup>19</sup>Lino was sentenced to 49 months imprisonment, Gangi to 97 months imprisonment, and Lombardo to 96 months imprisonment.

<sup>20</sup>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.

<sup>21</sup>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.").

<sup>22</sup>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.").

<sup>23</sup>Froncillo was sentenced to 21 months imprisonment.

<sup>24</sup>Dionisio was sentenced to 97 months imprisonment, Locascio to 63 months imprisonment, and Slavin to 60 months imprisonment.

<sup>25</sup>See Diana B. Henriques, "A Brutal Turn in Stock Frauds," *N.Y. Times*, Nov. 2, 1999 at B1.

<sup>26</sup>Most of these actions did not allege the involvement of organized crime.

<sup>27</sup>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).

<sup>28</sup>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.

<sup>29</sup>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).

<sup>30</sup>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).

<sup>31</sup>1933 Act [Rel. No. 7645](#) (Feb. 26, 1999).

<sup>32</sup>The Business Week Article, *supra* note 14 at 94.

<sup>33</sup>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.

<sup>34</sup>The 1999 Bill is co-sponsored by Senators Daniel Akaka, Max Cleland, and Judd Gregg.

<sup>35</sup>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.

<http://www.sec.gov/news/testimony/ts082000.htm>