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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

SECOND SESSION

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SEPTEMBER 13, 2000

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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.

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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 losses. 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 organized 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 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, 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 received 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 Department 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.

\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.

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.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

\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 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.').

\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.').

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

\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.').

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

\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 customers, and provide a monthly statement to clients disclosing the market value of all penny stocks in their accounts.

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

\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).

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.

\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.

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

\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.

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.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.

\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.

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

\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.'').

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

\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.'').

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.²³

\23\ Froncillo was sentenced to 21 months imprisonment.

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

\24\ Dionisio was sentenced to 97 months imprisonment, Locascio to 63 months imprisonment, and Slavin to 60 months imprisonment.

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.²⁵

\25\ See Diana B. Henriques, A Brutal Turn in Stock Frauds, N.Y. Times, Nov. 2, 1999 at B1.

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:

- <bullet> The manipulation of numerous microcap stocks.
- <bullet> 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.
- <bullet> 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.
- <bullet> 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.

<bullet> 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.

<bullet> 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.

\26\ Most of these actions did not allege the involvement of organized crime.

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.

\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).

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.²⁸

\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.

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

\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).

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

\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).

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

\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.

\32\ The Business Week Article, supra note 14 at 94.

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.

\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.

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.

\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.

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.

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). 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 Rico. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

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 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

 \2\ ``Wise Guys on Wall Street'' by John Connolly; George Magazine;
December, 1998

 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 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.

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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 2\1/2\ 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:]

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zMr. 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 enforcement 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 representatives, 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 to 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 Healthtech'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. NASDR 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 approximately 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 knowledgeable 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 successful 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 multimillions, 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 losses 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

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ALABAMA.....	13
ALASKA.....	0
ARIZONA.....	10
ARKANSAS.....	1
CALIFORNIA.....	25
COLORADO.....	6
CONNECTICUT.....	2
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

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