THE THEFT AND SUBSEQUENT DISPOSITION OF SECURITIES AND ORGANIZED CRIME'S ALLEGED INVOLVEMENT THEREIN: A DESCRIPTIVE STUDY

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by

W. C. Mullan

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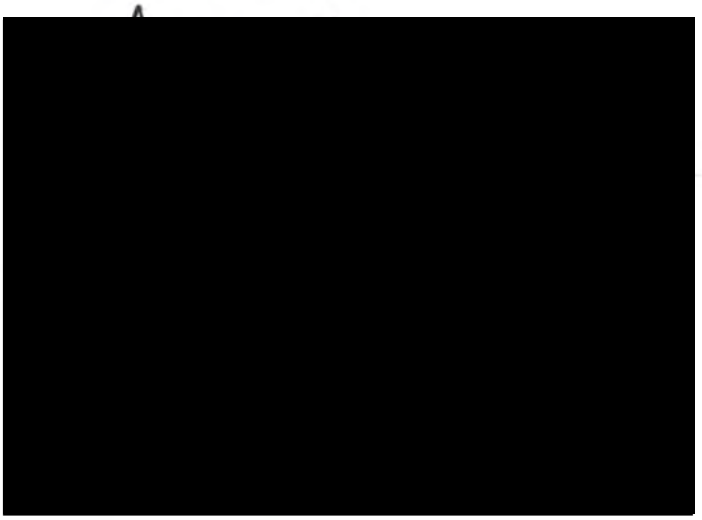

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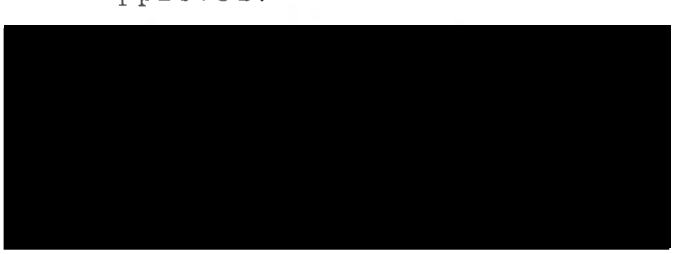

ABSTRACT

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Purpose

The primary purpose of this study is to provide an analysis of the theft and subsequent disposition of securities and to ascertain how involved organized crime is in these matters. The specific objectives of this study are:

1. To study the origins and development of organized crime in the United States.

2. To trace the development of organized crime in the United States from its early origins to its present existence as a large scale, business type operation with diversified and widespread investments and operations.

3. To study the origins and development of the securities industry within the United States.

4. To analyze the modern operations of the securities industry to ascertain how stock certificates and associated paper work are processed.

5. To determine what aspect of the securities industry began to malfunction and enabled the widespread thefts of securities to be accomplished with apparent ease.

6. To determine the scope of securities thefts, and the methods by which they were stolen.

7. To ascertain the existence of and the extent of organized crime's involvement in the theft and subsequent disposition of securities.

8. To determine the methods by which these stolen securities are disposed.

9. To analyze and evaluate the recommendations being offered to control and reduce the losses incurred through the theft and disposition of stolen securities.

Methods

The primary method of research was through the analysis of the existing literature in this area. The prime source document was the Hearings on Organized Crime and Stolen Securities held in 1971 by the Permanent Subcommittee on Investigations of the Committee on Government Operations of the United States Senate.

Additional information was requested and received from various securities industry representatives and governmental agencies.

Findings

Some of the more salient observations derived from this study were:

1. Organized crime does exist in the United States and most often functions as a supplier of desired, illicit goods and services.

2. Organized crime as it is known today first began operating as a large scale operation during Prohibition.

3. Because of increased sales volume and the increased volume of paper work handling associated with these increasing sales, the securities industry experienced, during the late 1960's, a period where the paper work operations became overburdened, and consequently, it failed to function properly. This failure enabled widespread thefts of securities to be perpetrated with apparent ease.

4. Organized crime's central function in the theft and subsequent disposition of securities appears to be in providing the means and methods of disposition.

5. Of the many proposed remedies being suggested, the one which calls for the complete elimination of the stock certificate is the only one being offered which would remove the single piece of paper which makes the theft of securities and their subsequent disposition possible.

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CHAPTER I

BACKGROUND OF THIS STUDY

In January, 1971, Senator John L. McClellan, Chairman of the Permanent Subcommittee on Investigations of the United States Senate's Committee on Government Operations, announced that the subcommittee's staff was investigating the role of organized crime in the sizable thefts of stocks, bonds, and other negotiable instruments from brokerage houses, banks and the United States mails. Senator McClellan emphasized that the staff findings would:

> ... show conclusively that organized crime elements have taken advantage of operational weaknesses and inadequate security procedures in the brokerage industry to steal and market negotiable securities, especially U.S. Treasury notes and bonds (The Wall Street Journal, 1971, p. 19).

At his January, 1971, press conference Senator McClellan stated that public hearings would be held in the spring of that year. The public hearings, convened pursuant to Senate Resolution 31, Section 4, passed March 1, 1971, were held during June and July, 1971; the hearing transcripts were published later that year. During the hearings Senator McClellan repeatedly enunciated the primary purpose of the Permanent Subcommittee on Investigations:

> While that is not the primary function of this subcommittee to develop criminal cases--the purpose of it is to examine conditions with a view of ascertaining whether legislation may be needed to strengthen existing law, so

> as to bring about better law enforcement in organized crime areas, and so forth (Hearings, 1971, Part 3, p. 672).

While listening to testimony, Senator Percy delineated the specific purpose of these particular hearings:

> ... I would again get back to the principle of what we are after. We have tried to develop for the public and the banking community and investment bankers, the pattern of what we see operating within the ranks of organized crime.
>
> The purpose of these hearings is to alert every financial institution and unsuspecting individual as to practices that are now a pattern so that they can take the necessary steps to protect themselves (Hearings, 1971, Part 4, p. 1118).

Rationale

Since the publication of the transcripts of these hearings, there have been some public discussions of this problem, and various professional publications in the fields of business and criminal justice have reported on some of the solutions proposed to eliminate or reduce the financial loss from the theft of securities. However, there has not been any major study of the problems as they existed prior to the public hearings and the revelations made during the hearings.

The purpose of this study is to review and analyze: (1) the problems of the theft and subsequent disposition of securities; (2) organized crime's alleged involvement therein; (3) selected portions of the testimony given before the Permanent Subcommittee on Investigations; and (4) the many proposed solutions. Incorporated into this study are the purpose statements of Senators McClellan and Percy.

Outline

This study will begin with a brief analysis of the origins, history, development and expansion of organized crime in the United States. Chapter II will deal with an attempt to answer the questions as to from where did organized crime come; what events are important in its history; and how or why did it become interested in the securities industry.

Chapter III will concentrate upon the operations of the securities industry, particularly the functioning of the major stock exchanges and large brokerage houses. Of special interest will be the period from 1965 to 1970 during which the industry became operationally handicapped because of the volume of paperwork to be processed.

The study will then attempt in Chapter IV to fuse these two subjects of organized crime and the securities industry together and describe the theft and subsequent disposition of securities. Two key issues in this discussion will be the ease with which the thefts were accomplished and the volume of stolen securities which were disposed of.

In the final chapter, Chapter V, the proposed remedies will be presented, analyzed and evaluated to determine if they will substantially eliminate or reduce the financial losses being experienced through the theft of securities.

Method of Research

The primary method of research for this study is a review of the existing, available literature. It is noted that some of the materials presented at the executive sessions and at the public hearings of the Permanent Subcommittee on Investigations were not published but were retained in the files of the subcommittee, and were not available for analysis.

In addition to the existing literature, the major brokerage firms, stock exchanges and regulatory agencies were contacted, and some of these organizations furnished information which has been incorporated into this study.

CHAPTER II

THE ORIGIN AND DEVELOPMENT OF ORGANIZED CRIME IN THE UNITED STATES

For this study, initially, it is necessary to have an understanding of the phenomenon commonly known as organized crime. This chapter will be devoted to a discussion of this phenomenon. Considered first will be the discussion which continually rages as to whether there really is such a thing as organized crime. After that question is answered, organized crime will be defined and labelled. Then the question as to whether organized crime as it allegedly exists in the United States is strictly a native body which originated in this country or whether organized crime was wholly imported from a foreign country will be resolved. The history of organized crime will then be further analyzed, and the prime significant event which marks the birthdate of modern organized crime will be mentioned. Finally, organized crime's growth and development after that period will be presented.

Organized Crime: Does It Exist?

Although it is most difficult to know where to begin a discussion of organized crime, one rather obvious starting point is to attempt to answer the question as to whether organized crime exists. Despite the fact that the media and the

professional journals are full of discussions of organized crime, there is considerable argument as to whether such a thing exists. As late as 1970 the discussion was still heated. Morris and Hawkins (1970) devote a chapter of their book to a discussion of the existence of organized crime, and they entitle this chapter "Organized Crime and God." The reason for the title is that they draw an analogy between the arguments made for the existence of God and those made for the existence of a national body of organized crime:

> The analogy (of organized crime) with theology is quite striking. Nor is it merely a matter of occasional similarities or likeness but rather of a systematic resemblance recurring in a wide variety of different sources. The parallelism is so pervasive that it is difficult to dismiss it as altogether fortuitous ... .
>
> But even when organized crime is not identified with the Mafia, it is still referred to in terms which imply divine attributes such as invisibility, immateriality, eternity, omnipresence, and omnipotence ... .
>
> As with the Diety, however, direct knowledge of this phenomenon is apparently not vouchased to us (Morris and Hawkins, 1970, pp. 203-207).

To support their contention that there is no such thing as organized crime, Morris and Hawkins (1970) cite earlier disbelievers in the theory of the existence of a body of organized crime. When a researcher reviews the literature on organized crime, he sees that much of this writing is based upon myth and unsupported deductions and conclusions rather than upon observable facts. Yet, persuasive and sound arguments can be made for accepting the belief that organized crime, in some form, does exist. The key to this argument is summarized by an unnamed Cleveland, Ohio, police official who

pointed out to Albini: "The presence or absence of organized crime here or anywhere depends upon how you define it (Albini, 1971, p. 21)."

Defining Organized Crime

The next step in this discussion is to adopt a suitable definition of organized crime. There are as many definitions of organized crime as there are so-called experts on the subject. For this study, many of the existing definitions of organized crime were analyzed, and the ones which appeared the most appropriate will be discussed and adopted. Johnson (1963), a former member of the United States Attorney General's staff who specialized in studying organized crime, offers this definition:

> As used in this article a criminal organization is a group of considerable size which engages in criminal activity over a long, usually indefinite, period of time. The size of the organization will vary, being composed of enough members to maintain a monopoly in its chosen fields of endeavor in a selected geographic area. The phases of criminal conduct which the organization may enter likewise will vary greatly. But ordinarily an organization will concentrate its efforts in the distribution of commodities and services. Moreover, a single organization typically will diversify with substantial interests in several lines of illegal activity. The most constant and unique element in the definition is the duration of the groups' intended existence. Unlike most criminal groups, but like most business enterprises, a criminal organization contemplates a continuous indefinite life span ... .
>
> At the present time, criminal organizations appear most active in six fields of endeavor--illegal gambling, the distribution of narcotics, racketering, prostitution, shylocking and the infiltration of legitimate business. The newest and most rapidly expanding spheres of organization are 'shylocking,' and the ownership of legitimate business (Johnson, 1963, p. 40).

Jonhson (1963) contends that the most constant and unique element in the definition is the duration of the group's intended existence. In his definition Albini (1971) argues that the concept of organization itself is the most distinguishing aspect of organized crime.

Albini (1971) explains that there are types of crimes which are more likely to be committed individually, and then there are crimes, such as blackmail, extortion and high-jacking, which lend themselves to collective, organized behavior. The key concept for Albini (1971) is interaction oriented toward the attainment of general or specific goals. After discussing the elements of interaction required, such as personnel recruitment and removal, Albini gives his definition of organized crime:

> In a very broad sense, then, we can define organized crime as any criminal activity involving two or more individuals, specialized or nonspecialized, encompassing some form of social structure, with some form of leadership, utilizing certain modes of operation, in which the ultimate purpose of the organization is found in the enterprises of the particular group (Albini, 1971, p. 39).

Albini (1971) then discusses four types of organized crime. The political-social type of organized crime is that which has an ultimate goal, either the changing or the maintaining of the existing social or political structure; the current various warring Irish religious groups would be considered organized criminals by this definition. Mercenary organized crime is considered predatory, for it is committed for direct financial profit. In discussing the

in-group-oriented organized crime, Albini (1971) uses motorcycle gangs and juvenile gangs as examples. The fourth type and the one of most concern to both Albini (1971) and this study is what he calls syndicated crime.

> Syndicated crime in its most constricted sense differs from other types of organized crime primarily because it provides goods and/or services that are illegal, yet for which there is a demand by certain segments of society. When the nature of these goods and services is such that the demand continues over a long period of time the syndicate develops a structure which makes it possible to provide these services. The specific structure the syndicate takes, as we shall see, depends upon the activity in which the particular syndicate is engaged (Albini, 1971, p. 47).

These definitions of Albini (1971) and Johnson (1963) are cited because they appear to supplement each other and provide a composite definition which can be adopted as a theoretical framework for this study.

Although he published his paper six years before Morris and Hawkins (1970) published their book, Johnson (1963) offers the best refutation to their argument, cited earlier, that organized crime as some type of national entity does not exist.

> At present there is a vocal controversy raging among experts in law enforcement over the existence of a Mafia and a national syndicate which dominates organized crime throughout the country. It is irrelevant to the purpose of this article whether there is one large nationwide criminal organization or a number of local ones. ... It is equally immaterial whether it is controlled by the Mafia (Johnson, 1963, p. 401).

Naming Organized Crime

The above quotation also resolved the problem, at least for the purposes of this study, as to what name should be assigned to organized crime. A review of the literature reveals that in the past considerable time and attention have been devoted to correctly naming organized crime. In the book, which was a result of Cressey's (1969) work for the President's Crime Commission Task Force on Organized Crime, eight pages were devoted to a discussion of the various names previously used to label and identify organized crime, and he then concludes his discussion by adopting a new label--confederation. Added labels and names do not appear to do anything more than confuse the issue. Johnson (1963) and Albini (1971), when discussing and defining organized crime, simply referred to it by that name (organized crime), and this label is deemed adequate and appropriate for this study.

Origins of Organized Crime

Thus far in the discussion organized crime has had its existence acknowledged and has been defined and named. It is now necessary to discuss, if not answer, the tandem questions of where did organized crime come from, within or without of the United States, and regardless of its origin, why and how did organized crime gain such a strong and lasting base in the United States?

In reviewing the literature one discerns that most, if not all, of the author's attempt to deal with this first question of whether organized crime was "imported" from Sicily or is something native to this country. Cressey (1969) is one author who, without giving a definite answer, would imply that there is a direct causal relationship between the Sicilian Mafia and organized crime in the United States.

> While we are confident that American organized crime is not merely the Sicilian Mafia transplanted, the similarities between the two organizations are direct and too great to be ignored. ... There is a remarkable similarity between both the structure and the cultural values of the Sicilian Mafia and the American confederation.
>
> ... There have been extensive contacts between Sicilians and Americans. This does not mean that the Mafia has diffused to the United States, however. Whatever was imported has been modified to fit the conditions of American life (Cressey, 1969, pp. 8, 25).

Other sociologists would argue that if anything was imported, it was a culture and not a Mafia organization as such. Ianni (1972) spent several years living with and studying a "family" of organized crime, and this family was of Italian origin. His answer to the question of importation is quite different from Cressey's (1969).

It seems quite reasonable to conclude from Ianni (1972) and Albini (1971) that what the Italian immigrants brought with them was a culture which included a tradition of the Mafia, but this was not a criminal organization per se which was imported. With respect to the mafia tradition being a part of the culture of those who emigrated from southern Italy and Sicily to the United States, however, it is important to

remember that this mafia tradition was deeply ingrained in the culture, and this aspect of the culture had existed for centuries (Ianni, 1972; Albini, 1971).

Even Cressey (1969) acknowledges that no matter what the origin of organized crime in the United States in general and the genesis of the Cosa Nostra in particular, it is obvious that "this organization is indigenous to the United States. It does things 'the American Way' (Cressey, 1969, p. 26)."

If the organization of organized crime was not imported, then, the question as to from whence organized crime came remains unanswered. In attempting to determine the sources and causes of organized crime in the United States, Albini (1971) discusses two possible approaches to the question. The first approach is the Evolutional-Centralization approach which does assume that organized crime had its roots in Sicily and subsequently evolved from that model in this country. Albini (1971) discredits and dismisses this approach.

Albini (1971) adopts the Developmental-Associational approach which contends that the causes and origins of organized crime are rooted in those social conditions and factors which are peculiar to this country and society. Organized crime, according to Albini (1971), developed in this country in conjunction with or because of the other social conditions and institutions that were formed and nurtured.

Tyler (1963) is in agreement with this developmental theory, and he traces the origins of organized crime back to

the early history of this country. Tyler (1963) believes that the continued presence of the frontier in the United States has had a lasting impact upon the history and culture of this country. The frontier of the "wild west" was subsequently replaced and mimicked in the ghettos of the emerging cities. The gangs of Dalton and James were replaced by the gangs of ghetto youths.

At least three other authors, Albini (1971), Bell (1960) and Ianni (1972), mention the relationship between the development of juvenile gangs and the recruitment process of organized crime. All of these authors point out the relationship between the immigration patterns of the United States and the development of juvenile gangs. Each also notes that the Irish and Jewish immigrants preceded the Italians both in juvenile gang activities and in organized crime.

Apparently, each newly established ethnic gang had as one of its main functions the protection of its "turf" from the already established gangs of earlier immigrant groups. The Jews had formed such gangs to protect themselves from the Irish, and Italian youths had to protect themselves and their territory from both the Jewish and Irish gangs.

What effect did these ethnic gangs have upon the development of organized crime? Bell refers to the transfer of certain types of behavior and existence from one block of European immigrants to another as a "queer ladder of social mobility (1960, p. 176)." On this ladder the immigrant gangs

first participate in criminal activity because that is the only endeavor open to them. Then, after becoming somewhat established and successful, the gang members transfer into legitimate economic and political activities.

Bell (1960) further notes that because the Irish and Jewish immigrant preceded them in gaining a foothold on legitimate activities, the Italian immigrants had more difficulty in gaining access to legitimate opportunities in business and politics. In his discussion, Bell (1960) paraphrases an observation made in the 1890's by the sociologist Jacob Riis and contends that the Italians came in at the bottom of the ladder of political and economic mobility and stayed there. He states that this especially holds true with respect to organized crime. The time frame for this discussion is the late nineteenth and early twentieth centuries.

With respect to the question as to why the Italian immigrants remained at the bottom, involved in organized criminal activities, will be answered in the next section when prohibition as a catalyst is discussed. However, in the following discussion it is again important to remember that the traditions the Italian immigrants, especially the Sicilians, brought with them differ greatly from the traditions of the immigrants from various parts of northern Europe. This tradition included the Mafia culture which had a very long history and was deeply ingrained in the immigrants (Ianni, 1972; Albini, 1971).

The Modern Development of Organized Crime

The next question to be answered is why or how did the Italian immigrants become locked into criminal activities of an organized nature. Of the questions posed in this chapter, this one is the easiest to answer. Anyone involved in criminal activity was affected tremendously in January, 1919, with the passage of the Volstead Act; i.e., prohibition.

> The great watershed of the activity of organized crime in the United States was the year when prohibition was passed. The Eighteenth Amendment created a vacuum into which criminals stepped with force and vigor (Woetzel, 1963, p. 4).

Organized crime as it is known today appears to have its genesis rooted in prohibition. Tyler offers an explanation as to why this is true:

> To the underworld the prohibition scribbled on any commodity or service, is translated to read profits, whether the item is 'alky' smut scab-herding, bombing or murder (Tyler, 1963, p. 333).

The providing of illicit alcohol required, however, something which the criminal and juvenile gangs operating in the various regions of the country had not had prior to this time--cooperation. To import or manufacture alcohol required transportation and distribution systems that transcended geographic areas and the formerly sacred regional "turfs" of the existing criminal gangs. Thus, modern organized crime developed in response to a need of society.

All of the literature reviewed points out that organized crime does serve certain needs, and apparently, none was more

historically significant than the supplying of alcohol during the period it was prohibited by law. What were once ethnic, regional gangs became organized corporate businesses providing desired goods and services.

Thus, organized crime developed in response to a need within the society. In paraphrasing an unnamed French sociologist, Ploscowe (1941) wrote that the cliche "that societies have the criminals they deserve" is a truism. Bell (1960) offers an explanation as to what it is within this society that enabled the need for and development of organized crime.

> Americans have had an extraordinary talent for compromise in politics and extremism in morality. The most shameless political deals (and 'steals') have been rationalized as expedient and realistically necessary. Yet in no other country have there been such spectacular attempts to curb human appetites and brand them as illicit, and nowhere else such glaring failures. From the start America was at one and the same time a frontier where 'everything goes' and the fair country of the Blue Laws. At the turn of the century the cleavage developed between the Big City and the small-town conscience. Crime as a growing business was fed by the revenues from prostitution, liquor, and gambling that a wide-open society encouraged and that a middle-class Protestant ethos tried to supress with a ferocity unmatched in any other civilized country. ... In America the enforcement of public morals has been a continuing feature of our society (Bell, 1960, p. 116).

Earlier in 1931, Walter Lippmann made a similar observation: "The underworld lives by performing the services which convention may condemn and the law prohibit it, which, nevertheless, human appetites crave (Lippmann, 1931, p. 3)."

Thus the history of modern organized crime, which congealed and thrived while providing illicit goods and services,

is inexorably linked with the Eighteenth Amendment (prohibition). This amendment, adopted on January 29, 1919, was, however, repealed as of December 5, 1933.

The next questions which must be answered are how or why organized crime continued to thrive and expand after prohibition was repealed even though this catalyst which made organized crime possible no longer existed. To answer this question it is necessary to recall the distinguishing factor in Johnson's (1963) definition of organized crime. He pointed out that the most constant and unique element in the definition of organized crime is the duration of the group's intended existence. Johnson (1963) argues that organized crime, unlike most criminal groups but like most business enterprises, contemplates a continuous life span.

Schelling (1967), an economist who specializes in studying organized crime, concludes that prohibition provided organized crime entry into what economic developers call self-sustained growth; i.e., once they got started and got a foothold in the economic structure, organized crime took off on its own and did not need prohibition to sustain its existence. This analogy to business which both Schelling (1967) and Johnson (1963) make is appropriate and one made by most students of organized crime.

> Whatever form they (organized crime) take, financial profit is the goal, which they share with the entrepeneurs of legitimate business. Indeed, in their perverted way, they subscribe to the tenets of American entrepeneurship, ... both have in common a hope for continuity and survival (Sellin, 1963, p. 13).

Sellin (1963) also points out that legitimate business and organized crime share such qualities as the institutionalization of innovation, risk-taking, growth, and emphasis on success with income as the prime measurement thereof.

Since this analogy of organized crime and legitimate business is commonly accepted, one possible way to answer this question of why organized crime did not disappear or diminish in influence with the repeal of prohibition is to answer the question of what does a legitimate business do when faced with the possibility of losing one of its major marks. It is assumed that a legitimate enterprise does not want to go out of business; one alternative to this is diversification.

Taylor and Wills (1971) offer a useful discussion of business diversification which is deemed relevant to this discussion. Their broad definition of diversification is that it is the term applied to the action of redeploying resources available to a business enterprise into activities substantially different from those followed in the past.

Taylor and Wills (1971) point out that the requirements for diversification generally involve engaging in industries, technologies and markets which are new to this corporate entity. Also new financial investment is customarily required. The basic reason for diversification is the prospects for the existing line of business or the required future performance (growth in sales and profits) will not be met.

Taylor and Wills (1971) continue their discussion by stating that there are two major forms of diversification: unrelated diversification in which an entirely new business area is entered; and related diversification where common factors, such as technological know-how, marketing facilities, or production facilities are present.

From what is known about organized crime, it would appear that it utilized both forms of diversification. Stanley Penn (1968), a reporter for The Wall Street Journal, discusses organized crime's diversification process in the abstract.

> By various methods, organized crime is infilitrating a growing number of legitimate businesses. According to the Justice Department, organized crime now has links with tens of thousands of businesses and businessmen in such widely ranging fields as electronics, trucking, banking, construction, real estate and food and health services.
>
> One motive, surprisingly, is to establish a money-making front to justify the criminals' luxurious way of life. Without such a front, the Internal Revenue Service would be constantly investigating Mafia members to find out where they get the money for their high living. The front, the criminals hope, provides the answer.
>
> The Mafia has plenty of cash to invest in these legitimate enterprises. Its yearly revenue from gambling, narcotics, usurious loans, prostitution and the numbers game has been estimated at as much as $50 billion (Penn, 1968, p. 4).

Penn's (1968) discussion emphasized another well established business principle to which organized crime seems to adhere. That is, that excess profits should be reinvested into the business or into new businesses. In his study of one "family" of organized crime, Ianni (1972) discusses diversification of organized crime's business interests and gives specific examples thereof.

> With the onset of the 1930's and the end of Prohibition, the Lupollo business complex underwent another change. A very profitable sector had been closed off, but Giuseppe had already begun the Italian lottery and was developing it into the new numbers or policy game. ... With bootlegging profits and new gains from gambling Giuseppe expanded into new, legitimate areas of business.
>
> The Castellammarese Wars and the earlier struggle over the Brooklyn and Manhattan 'chairs' impressed on Giuseppe the insecurity of illegitimate enterprise. After 1932, he moved with even greater dispatch and resolve to strengthen the legitimate enterprises of the family while reducing the illicit activities (Ianni, 1972, pp. 72-73).

Ianni (1972) noted that in 1970 this "family" business had increasingly concentrated on legitimate enterprises; but the illegal activities, primarily gambling, bookmaking, and loan-sharking were still major sources of revenue and were expected to be continued as such.

Summary

This discussion has acknowledged the existence of organized crime and has both defined and labelled this organization of criminal activity. An attempt was made to discern the origin or organized crime. It was concluded that although a considerable number of immigrants brought with them a culture and tradition which included organized criminal activities of various types, organized crime as it currently exists in the United States operates in what Cressey (1969) refers to as "the American way." It was pointed out, however, that those who emigrated from southern Italy and Sicily brought with them a deeply ingrained Mafia tradition.

In tracing the development of organized crime in the United States, it was discovered that there is a parallel between the development of this country's western frontier with its freewheeling atmosphere and the collective activities of the ethnic gangs of the urban ghettos.

Many knowledgeable students of organized crime have concluded that it was during the time of prohibition which these loosely organized gangs solidified and began to expand. This organizing was done in order that these criminal gangs could meet the needs of the society by supplying illicit alcohol.

Once organized, these criminal enterprises continued to exist despite the repeal of prohibition. Since the 1930's the development of organized crime has been similar to the development of legitimate businesses.

Organized crime has continued to prosper as a supplier of illicit goods and services; with the profits from these activities, organized crime was reinvested and diversified into other endeavors. A review of the literature of both organized crime and business theory indicates that in these past forty years organized crime has exhibited tremendous growth potential, and no change is forecasted. During earlier Congressional Hearings on organized crime, Senator Kefauver (1951) emphasized that monopoly, which often follows diversification, is the key to organized crime's methods of operation. Business analysts have consistently pointed out that monopolies, once

established, are notably difficult to destroy or control. It therefore seems apparent that organized crime, as it exists today, is both monopolistic and extremely interested in continued diversification.

CHAPTER III

THE FUNCTIONING AND/OR DYSFUNCTIONING OF THE SECURITIES INDUSTRY

> The greatest gambling enterprise in the United States has not been significantly touched by organized crime. That is the stockmarket. (There has been criminal activity in the stockmarket, but not on the part of what we usually call 'organized crime'). ... The reason is that the market works too well (Schelling, 1967, p. 124).

In retrospect it appears that the above statement was inaccurate at the time it was made. According to the testimony given before various congressional committees concerning the operations of the securities industry, it was in 1967 that organized crime began or increased its illegal operations in the securities area. It appears also that it was for the exact opposite of the reason given by Schelling (1967) that entry into the securities industry by organized crime was facilitated. For numerous reasons, which will be explained subsequently, it was in 1967 approximately that the securities industry became beset with operational problems. According to many sources, from that time forward the securities industry did not function well.

This chapter will be devoted to the study and analysis of the securities industry. Initially, the industry and its function will be defined. Then its origins, history, and purpose will be presented. Connected with the emergence of the

securities industry is the development of the national and regional stock exchanges; these will be defined and explained.

Late in the history and development of the securities industry, federal regulation was introduced to it. The reasons for this federal regulation will be explored briefly, and the scope and functioning of this federal regulation will be discussed.

Under the purview of the national and regional stock exchanges are the individual brokers and dealers of securities. The function and operations will then be examined.

One of the key issues in the operations of the securities industry is the processing of paper which accompanies the sale and purchase of each share of stock. This processing of paper will be carefully analyzed, and the increase in volume of this paper which occurred during the late 1960's will be detailed. Many analysts believe that during this period the paperwork processing units of the securities industry almost completely failed to function, and they also believe that this was a crucial factor in organized crime elements gaining access to the securities industry. This aspect will be examined fully, as will the complex movement of the individual pieces of paper known as stock certificates. The stock certificate is of prime interest because this is what was stolen and subsequently disposed of for illegal gain.

Because of the increased volume of paper and the breakdown in the processing of this paper, the securities

industry and the regulatory agencies initiated a number of corrective actions; these will be described and discussed.

The purpose of this discussion will be to present the situation as it was in the securities industry at the time the theft and subsequent disposition of securities became a serious problem.

Definitions, Origins, Purpose, and History

Definitions

Initially it is necessary to define for this study what is meant when the term "securities industry" is used. Clendenin and Christy (1969) offer a definition of investments which is required to understand why the securities industry developed.

> In the broad and customary sense of the term an investment is any asset or property right acquired or held for the purpose of conserving capital or earning income. This comprehensive definition does not distinguish between safe and hazardous investments, tangible and intangible investments or between directly owned assets and institutionally managed ones, such as savings accounts and life insurance. It simply recognizes that ... all fulfill the same basic function, that of employing their owner's funds (Clendenin and Christy, 1969, p. 41).

In the above definition, there are many types of investments. Later in their discussion Clendenin and Christy (1969) list fifteen different types of investments. They are: savings bank deposits, life insurance policies, savings and loan accounts, United States securities, state and municipal bonds, corporate bonds, corporate stocks, investment companies, mortgages and loans, home ownership, real estate ownership,

business ownership, pension rights, education and self-improvement. Many of these types of investments are self-evident. This study will be concerned with only certain of these, primarily those investments in Unites States government securities, state and municipal bonds, corporate bonds and corporate stocks. For the purpose of this study the definition of the securities industry will be limited to transactions in these specific types of investments.

Origin and Purpose

The securities industry has existed in this Country almost from its inception. Although it is an over simplification, it could be said, with some justification, that making money, the goal of investing, has been the key goal in the development and growth of this Country from its founding. Leffler and Farwell (1963) report that there is considerable doubt as to when the first securities markets began to operate, but they believe that as early as 1725 there were public dealings in securities in New York City. These transactions took place at an auction market in lower New York at the foot of Wall Street, so, although the financial district of the nation has expanded at least to include all of Manhattan, the name remains the same. The securities market first achieved national attention when the federal government was established and Alexander Hamilton, the first Secretary of the Treasury, recommended that the newly created federal government redeem all of the Revolutionary War Bonds, both those of the Continental Congress and those of the colonies. As these bonds had

depreciated greatly, financial speculators created a boom market prior to the final decision to redeem them. From that time on the securities industry was off and running, and it experienced many booms and a few busts in the course of the next 195 years.

History

The first written agreement among New York stockbrokers was signed in 1792, and what is now known as the New York Stock Exchange was initially organized in 1817. Prior to the signing of that first written agreement, known as the Buttonwood Agreement (because trading was done under a Buttonwood Tree on Wall Street), commissions from trading were made only by the auctioneers and not by the securities dealers. The Buttonwood Agreement provided that the brokers would deal only with each other, thereby eliminating the auctioneers. This agreement also initially imposed self-regulation of dealers by setting the rate for commissions. Gras and Larson (1939) point out that:

> The New York Stock Exchange started as a voluntary, unincorporated, private club of members to provide themselves a trading place and rules governing trade in securities. It attempted to be exclusive and prizing secrecy it shunned publicity in any form, holding to the ideal that its business was a private matter. Today the Exchange is still a voluntary association of members to provide a market place and rules of trading in securities, but it now stands as an institution weighted with public responsibility (Gras and Larson, 1939, p. 324).

Development of the Stock Exchanges

Clendenin and Christy (1969) describe the function of a stock exchange, and they point out that no matter whether

the exchange is national or regional in scope the function is the same.

> A stock exchange is an association of brokers formed to provide improved facilities for the execution of customer's orders. The main function of an exchange is to operate a trading room to which all of the brokers may bring their orders in a given list of securities. With a large number of customers buying and selling orders thus brought together, it is expected that many transactions can be completed (Clendenin and Christy, 1969, p. 210).

Clendenin and Christy (1969) point out that by bringing the buyer and seller together, the broker, a middleman in the transaction, earns a commission for his services.

Brookman (1970) traces the history of the New York Stock Exchange from its inception through its booms and crashes and points out that one of its most prosperous periods was immediately following the Civil War. It was at that time, while the nation was advancing its frontier and becoming a manufacturing power, that the stock exchange and the securities industry really began to function.

Brookman (1970) also explains that although the auctioneers were eliminated by the Buttonwood Agreement of 1792, an auction market was adopted in 1871 by the New York Stock Exchange because of the volume of business. As will be noted later, the volume of business transacted is a most important consideration in this study's analysis of the securities industry. Brookman's (1970) explanation of the auction market follows:

> The expansion of stock market activity made the call by stem of trading inadequate. It was abandoned in 1867,

> and by 1871 the exchange was trading on a continuous basis, with prices determined by the two way auction system--in which buyers compete with other buyers and sellers with other sellers. This enables the highest bids and the lowest offers to come together in the central market. The result is a constant adjustment of supply and demand for each security traded, reflected in changing prices (Brookman, 1970, p. 74).

Currently the New York Stock Exchange is the largest of the thirteen existing stock exchanges, and in conjunction with the smaller American Stock Exchange is national in scope. The other eleven stock exchanges are regional in nature, serving a specific geographic area.

According to the 1967 New York Stock Exchange Fact Book, the New York Stock Exchange handled in 1968 73.8 percent of the total dollar volume traded on all exchanges. The American Stock Exchange handled 17.8 percent of the total dollar volume traded in 1968, while the other eleven regional exchanges, combined, handled 8.5 percent of the total volume.

Summarizing, then, the stock exchanges have been established for two major purposes. One is to provide a place and a system by which brokers may trade in securities. The second reason is to provide an organization of self-regulation in the securities industry; i.e., to provide an organization which has the power to enact and enforce the rules of trading and the commission rates.

Introduction of Federal Regulation

It is apparent that through their associations of self-regulation, the stock exchanges and associated brokers and dealers have attempted to avoid government regulation. Other industries, such as the railroads and the oil industry, became subject to governmental regulation much earlier in their history than did the securities industry.

The reasons which precipitated the earlier government intervention into the businesses of the railroads and oil companies, business excesses and abuses which resulted in the public being harmed, are the same reasons that the government eventually intervened in the securities industry.

Mentioned earlier was the fact that throughout its history, the securities industry has been quite volatile, experiencing numerous highs or periods of great prosperity and boom markets, and other periods of bust or severe depression. The 1920's, while prohibition flourished and the country recovered from World War I, was a period of prosperity in which millions of Americans invested in stocks and bonds, many of them doing so for the first time with high hopes of "getting rich quick." The period of sudden decline known as the "Crash of '29," and the great depression which followed, had a tremendously significant effect on the subsequent history of the United States and its economy. It was during this period, 1933 to 1944, that the United States Congress passed a series of eight legislative acts and associated amendments which are

known as the Federal Securities Acts. Among other things, these acts established the Securities and Exchange Commission (SEC) which has as its responsibility the administering of these acts and the regulating of the securities industry. The practice of self-regulation still exists. In fact it is required by law. However, there is now a governmental regulatory agency to oversee and override the self-regulating bodies, and the reason given for existence of this agency is to provide for the protection of the investing public. In 1969, when testifying before the Subcommittee on Commerce and Finance of the House of Representatives' Committee on Interstate and Foreign Commerce, Judge Budge, then the Chairman of the Securities and Exchange Commission, discussed the role and function of the SEC.

Judge Budge explained that the SEC has three major responsibilities with respect to the securities industry. The first is to provide to the public financial information which is relevant to the securities being traded in the public markets. The second responsibility is to detect and prevent fraud and manipulation in the securities market. Thirdly, the SEC is responsible for the regulation of the public markets and of the brokers and dealers doing business in these markets. In performing these functions, the Commission is required by statutes to oversee the activities of the self-regulatory associations; thus the rules of the exchanges and of the National Association of Securities Dealers, a self-regulating

association comprised of most of the broker-dealers who do business in the over-the-counter, unlisted, securities, are subject to review by the SEC. The Commission is also authorized to review the disciplinary actions of the National Association of Securities Dealers, but not, however, those disciplinary actions administered by the exchanges.

Primarily, then, the function of the Securities and Exchange Commission is to act as a watch dog and to protect the public investor.

The Individual Brokers and Dealers of Securities

What has not yet been defined is the role and function of the individual securities and dealers and brokers who comprise the membership of the various stock exchanges and of the National Association of Securities Dealers; that is the intent of this section.

Clendenin and Christy (1969) discuss the role and function of the individual broker and dealer. They advise that as of 1967 there were some 5,000 brokers and dealers of securities, and these agencies handled or participated in investor transactions which, in 1967, exceeded $200 billion. This excludes dealings in short-term government securities.

There are, according to Clendenin and Christy (1969), three functions performed by brokers and dealers. There are investment banking bodies which market new securities. There are those securities dealers who deal in securities which

means the buying and selling of existing securities as merchandise with the firm's own money. Then there are brokerage firms which handle transactions as the customer's agent, and these firms operate solely on a commission basis. Clendenin and Christy (1969) note that many firms deal in at least two of these areas, and quite often it is difficult to determine where one function leaves off and another begins.

Clendenin and Christy (1969) further amplify the services provided to the investing public by brokers and dealers.

> Brokers and dealers offer the public many services, which may be grouped conveniently as information and advise, trading facilities, and general services.
>
> Investors in securities have need for much information about corporations, their capital structures, earnings, dividend policies, and prospects. ... Brokers and dealers can provide a great deal of help on these matters. ...
>
> Trading facilities offered to customers vary considerably. ...
>
> A broker or dealer is usually willing to provide free storage for a customer's securities if the customer trades often enough to vie the firm some revenue from the account. The securities can be kept in the broker's name, with interest and dividends being credited to the account or remitted to the customer as received; the broker can then execute telephone orders without the customer's signature. Brokers can also lend money to customers on their security collateral, either for securities trading or general purposes. ... This service is sometimes a highly convenient one, especially if the broker's own loan practices are generous (Clendenin and Christy, 1969, pp. 229-232, emphasis added).

The emphasis is added in the above quotation to highlight those aspects of the brokerage function which have particular importance to the theft and subsequent disposition of securities.

Operations of the Individual Broker

But before discussing the flow of stock certificates and related paper, and how the breakdown in this flow facilitated the theft of securities, a little further discussion of the role and function of individual brokers and dealers is necessary.

Robbins, et. al. (1969), report that as of 1969 there were approximately 3,900 broker-dealer firms registered with the Securities and Exchange Commission and actively engaged in one or more aspects of the securities industry. They noted that the broker-dealer firms vary considerably both in size and scope of activity ranging from one-office operations under the control of a single individual to giant corporate organizations with diffuse branch operations that are department stores of financial services. Operationally, firms cover a wide spectrum of operating capabilities from those that have the latest and most sophisticated electronic equipment to those that still rely upon part-time bookkeepers. While the smaller firms who utilize less sophisticated methods are more numerous, it is the larger type broker-dealer who handles a much larger proportion of the volume of securities transactions. Robbins, et. al. (1969), point out that overshadowing all of the industry are the some 650 firms that are members of the New York Stock Exchange; as noted earlier in 1968 the New York Stock Exchange handled almost 75 percent of all the securities business transacted.

Again it is necessary to set the limits of this study. Although the operation problems and the problems of theft of securities either directly or indirectly affected all those engaged in the securities industry, this study will center primarily upon the New York Stock Exchange and its some 650 member firms. These are the giants of the industry and the problems which they faced and the solutions they implemented reflect the entire gamut of all those options faced and decisions made by anyone dealing in securities.

Ownership of Securities

Before considering the processing of the stock certificate, it is worthwhile to consider the question of ownership of securities. When discussing the increase in trading volume of the stock exchanges, it will be pointed out subsequently that the major exchanges and brokerage houses have encouraged wide participation in the stock market and have actively sought out the small, individual investor. It should be noted, however, that now the majority of stocks and other securities are owned by large investors who are customarily known as institutional investors. Institutional investors include: insurance companies, investment companies, non-insured pension funds, non-profit institutions, common trust funds, mutual savings banks and bank administered trusts. In 1964, the most recent year this figure was found to be available, these institutions owned an estimated 35 percent of the market value of all New York Stock Exchange listed stock (Robbins, et. al. 1969). This is

significant because institutional investors customarily purchase stock with the intention of holding it for prolonged periods of time. This means that the stock certificates are held either by the institutional investor itself, a bank or the broker handling the institutional account. This means that the stock certificates are in a depository, and if they were removed, illegal or phony or stolen certificates were substituted for the legitimate certificates. It may be years before this fact, that the true stocks have been stolen, is discovered.

The Processing of Paper Work

An understanding of the flow of paper work which accompanies any sale or purchase of a share of stock or other investment is most essential for an understanding of the hows and whys of the theft and disposition of securities. Included in this section will be a discussion of the volume of trading in securities and how the increase in the volume of trading greatly overloaded the paper work process.

Processing of Buy and Sell Orders

Robbins, et. al. (1969), offer a very good discussion of the process by which orders are processed by the securities industry; they point out the interrelationship existing among the brokerage houses, the stock exchanges and the Securities and Exchange Commission. The typical transaction in the

securities business involves the sale and purchase of shares of stock and the change in registration (proof of ownership) to the buyer.

> After a sell order is executed, the customer forwards his certificate to the selling broker. The certificate is then sent to the transfer agent where it is canceled, the transfer registered, and a new certificate issued to the buyer. These steps involve myriad actions by the selling and the buying brokers as well as other organizations intrinsically associated with the securities markets. One is the corporation that issued the stock or the professional transfer agent (usually a bank) that maintains the corporation's stockholders' register. Another, in the case of a corporation with shares listed on an exchange, is the bank which serves as registrar and is charged with the responsibility of auditing the issue of shares. Also involved are the clearing houses, maintained by exchanges for clearing listed as well as certain unlisted securities (Robbins, et. al., 1969, pp. 14-15).

Robbins, et. al. (1969), point out that the procedure currently used is essentially the same as it was from the inception of the securities business. Also the buyer's broker takes actions and makes records similar to those initiated by the seller's broker. The following describes shares being delivered to the buyer's broker.

> Securities purchased through the firm are delivered to the Cashier's Department (Cage) which ascertains that they are in good form and performs the operations necessary to store them within the buyer's name. To keep track of the firm's inventory, the Stock Record Department maintains a double-entry bookkeeping system that identifies both the ownership and the location of all securities held within the firm (Robbins, et. al., 1969, pp. 23-24).

Although the securities industry is now subject to much closer self-regulation and regulation by the federal government, has made many studies of the ways it conducts business, and restructured itself several times (especially since the fall

of 1929), the securities industry essentially transacts business the way it did in the nineteenth century. The companies listing their stocks on the major exchanges have gone through major changes in the way they conduct business, but the exchanges have not.

The Stock Certificate

The key item or document in this flury of activity, and the key, or perhaps sole document involved in the theft and disposition of securities, is the stock certificate. Robbins, et. al. (1969), comment on this significant piece of paper:

> It is only a piece of paper--perhaps about the size of a page from this book--printed in color, impressed with the corporate seal, and highlighted by a picture of a design that depicts the corporation's activities. All in all, quite a bit of decorative paraphernalia, but still ... it is only a piece of paper.
>
> Our description of course, refers to the stock certificate. Except for some minor changes, it has remained steadfastly aloof from the dramatic advances that have occurred in the technology of communications. In the history of corporate development, the certificate has provided tangible evidence of ownership it had created a legal basis to effect transfer of corporate shares; and possibly, it has even afforded a decorative remnant of values lost in bankrupt enterprises. Not only do these functions appear unnecessary and susceptible to more efficient handling by modern means, but the certificates, as will be demonstrated, are an awkward instrument contributing substantially to the massive paper snarl that has plagued the securities industry during the past several years.
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> In a society that is slowly advancing toward cashless and checkless financial transactions, the stock certificate has no future (Robbins, et. al., 1969, p. 12).

But recently it has had a very sordid past. For the front office of the brokerage (involving the buying and selling of securities) to operate efficiently and, not incidentally,

profitably, the associated paper, i.e., the stock certificate and related paper work, must be moved and processed quickly and accurately.

Paper Work and Sales Volume Increases

To understand the increased volumes of paper work to be handled in the late sixties, a historical perspective is necessary. In 1964 the volume of shares traded per day on the New York Stock Exchange averaged 4.9 million shares per day, and it is important to realize that this daily average represented the highest daily average of shares traded in the past thirty years. In 1965, when researchers for the New York Stock Exchange predicted that it would not be until at least 1975 that the average daily volume would be around 10 million shares, it seemed a reasonable and logical prediction and one upon which future planning could be predicted. At the time, 1965, many in the securities industry thought that this ten year forecast was much too high.

However, the forecasters turned out to be very wrong, but they erred on the side of underestimating the growth in daily volume. Within two years the average volume of shares traded per day reached the 10 million share level. On April 1, 1968, the New York Stock Exchange established a new record for shares traded on a single day of 17.7 million shares traded. During that month, April, 1968, this record was shattered twice, and in June, 1968, 21.3 million shares were traded. For the entire year of 1968, the daily average number of

shares traded was about 13.0 million. As noted, the New York Stock Exchange is the pace setter in the securities industry, and as it experienced unprecedented growth and associated difficulties so did all other securities markets.

One mistake which appears to have been made during this period is that this growth was viewed as temporary, but past figures indicate that although the volume will usually recede after soaring, it has never receded all the way back to the earlier average levels. When discussing the increase in volume and the related operational problems, Securities and Exchange Commission Chairman Budge stated in 1969:

> Two major factors in the development of this situation have been (1) the failure of management of individual firms to regard the increase in activity as a permanent fixture of the business and (2) the absence of facilities for clear over-the-counter transactions, which involve the greatest number of firms and issues, and which have been estimated to equal or surpass, at least in number of shares, the total volume of all transactions effected on the national securities exchanges (Hearings, Part I, 1969, p. 56).

Table 1 shows that in seven years the volume tripled, and according to experts such as Chairman Budge, the increased volume is at least expected to remain about the same even if the extreme rate of increase does not continue.

As the table shows, from 1965 through 1968, the securities industry experienced an unprecedented growth in volume. Although it is not entirely relevant to this discussion to explain why this increase occurred, the question may be of more than a passing interest to the reader, so it will be answered.

TABLE 1

New York Stock Exchange Average Daily Transactions and Volume for Selected Years

Year	Average Daily Number of Transactions	Average Daily Volume
1961	20,700	4,085,000
1963	21,484	4,567,000
1965	29,896	6,176,000
1967	39,289	10,080,000
1968	42,940	12,971,486

Source: U.S. Congress, House. Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce, Hearings on Securities Markets Agencies, Publications Serial No. 91-9, 91st Congress, 1st Session, 1969, p. 9.

Reasons for Increases in Sales Volume

Robbins, et. al. (1969), attribute this phenomenal growth to the combination of two factors, sales promotion and business inflation. These two factors came together to form a powerful combatant that drove the market up and increased immensely the volume of trading. The business inflation aspect was related to the increase in manufacturing and production of material goods, which in turn is related to the increased military activities in South East Asia which were booming after August, 1965.

The sales promotion factor is more difficult to explain. World War II provided that nation's economy, to include the securities industry, with the means of full recovery from the depression of the thirties, and the leaders of the securities industry wished to perpetuate and increase the rate of recovery after the war ended, rather than face another period of decline. Following World War II, the securities industry entered a period where merchandising and salesmanship were of a major concern both to the individual brokerage houses and to the self-regulatory agencies. During this time there were extensive advertising campaigns, similar to the ones that are currently appearing on television. These advertising campaigns were supplemented with various sales promotion activities undertaken by the brokerage houses such as free investing courses. These sales oriented activities appear to have reached their most successful point in 1965, while at the

same time the economy was taking a natural upturn because of the war time economic activities. Consequently volume in the securities markets made gigantic climbs upward which exceeded all expectations and predictions.

Again it is important to remember a fact cited earlier, that although there was a considerable increase in the number of investors during this period of phenomenal growth, the institutional investors still tended to dominate the market and be the largest investors of securities.

Effect of Increased Sales on Paperwork Process

It is important to note that this increase in sales activity was actively sought for and the required planning was done. There were conscious decisions made during these post-war years to draw up plans to solicit more business. Robbins, et. al. (1969), point out, however, that very little of the front office planning for sales increases ever filtered back to the operational area; i.e., the back office.

> The planning that occurred in the back office, consisted, for the most part, of work studies and procedure analysis concerned with improving existing systems rather than with establishing plans for innovative methods. Management consultants were often engaged, but they were primarily used to solve specific short-term problems. ...
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> The depth of planning activities was not only characteristic of brokerage firms, it was also prevalent within the regulatory agencies. Planning staffs, responsible for future systems and strategy, are relatively new developments at major exchanges. Even now, personnel engaged in such activities are often so pressed by immediate problems, that their ability to formulate long-range programs is severly impaired. ...
>
> Historically, the stock exchanges have been far more concerned with instilling the idea of public stock ownership and policing the activities of their own members than

with systems and planning concepts (Robbins, et. al., 1969, pp. 53-54).

When the advertising campaign, assisted by business inflation, succeeded, the back offices of the brokerage houses and the stock exchanges were not equipped to handle the avalanche of paper which the sales efforts precipitated.

> Generally speaking, business is conducted in the brokerage back office the same way it was years ago. Recent observers of this antiquated scene were reminded of Dickens, as they described what they saw in terms of a 'green eye-shade era' in which 'Scrooge and Bob Crachit would still feel at home.' Computers had been introduced, but often in awkward out-of-the-way locations, at a slow rate, and without an overall systems-oriented viewpoint. Also, as additional personnel were recruited to help keep up with the growing number of securities transactions, processing functions were conducted in much the same manner ... . Since a customer's order had to pass through more hands, the chain of communication was longer and more complex, and there was more opportunity for error.
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> In brief, then, there has been little change in procedures but considerable augmentation of detail--more steps to accomplish the same transaction flow. Therefore in 1965, when investor interest soared, a massive volume of orders poured into this complex, archaic, and overly extended transaction system. Under these circumstances, the resulting error rate was inevitable. Although, errors were spread throughout the system, the departments that proved most vulnerable were Purchase and Sales, the Chashier's (Cage), and Stock Record (Robbins, et. al., 1969, p. 25).

The Purchase and Sales Department is responsible for the preparation of customer confirmation slips, floor tickets and other routine paperwork preparations. It also maintains comparison systems that verify the accuracy of transactions between parties to a trade, and it serves as the link with the clearing houses. All of these duties are relatively routine and uncomplicated if there is sufficient time and personnel to do them properly. High volume and a shortage of qualified

personnel can cause numerous errors to be made in this department, and this will drastically affect the flow of stock certificates and associated paperwork. It will be demonstrated that it was this breakdown in the flow of paperwork which facilitated the theft of stock certificates.

The Cashier's Department

With respect to enhancing the theft of stock certificates, the most important back office operation is the Cashier's Department (Cage). It has the responsibility for the physical handling and custody of all certificates. Robbins, et. al. (1969), describe the Cage operations in detail.

> ... Of all back office operations, this area was usually the first to break down and the hardest to restore to a reasonable degree of effectiveness. Even the management of those firms with relatively organized systems groaned when discussing this department. As one such official commented, 'Everything was wrong with the Cage: too rapid growth, lack of training, poor supervision, and poor working conditions (Robbins, et. al., 1969, p. 30).'

Within the Cage there is a tedious manual routine of checking endorsements and signatures. If the customer does not wish to deposit the certificate with the brokerage firm, there are additional steps required to send it to him. These often involve banks, transfer agents and other brokers.

There are, according to Robbins, et. al. (1969), three sections within the Cage. They are: the Receive and Deliver Section; the Box and Vault Section; and the Transfer Section.

When a certificate enters the Cage, it comes to the Receive and Deliver Section; it can be brought in any one of

three ways. Certificates can be carried or mailed in by the customer; they can be delivered by another broker or a bank; or they can be forwarded by the clearing house. Signature verifications, etc., are made by the Receive and Deliver Section.

From the Receive and Deliver Section, the stock certificate is carried to the Box Section.

> The Box Section of the Cage is basically a temporary storage place where certificates are physically stacked in one of three groupings: (1) segregation; (2) safekeeping; and (3) 'active' box. All fully-paid-for securities, held for customers and firm accounts in street name and not required as collateral in a margin account, are placed in segregation. All fully-paid-for securities that are in customer names are placed in safekeeping. All other securities are placed in the 'active' box. ...
>
> If a certificate is received and no change is required it is stored in the Box Section. In the event it is to be forwarded to the transfer agent for a change of registration, it is then shifted from the Box to the Transfer Section of the Cage. ... At the Transfer Section, a clerk records the certificate number and completes the transfer instructions so that both the certificate and a copy of the transfer instructions may be sent to the transfer agent (Robbins, et. al., 1969, p. 31).

Robbins, et. al. (1969), emphasize the importance of accuracy and control in the workings of the Cage.

> Throughout this entire process, accurate control over the movement of certificates is imperative. But the number of steps through which the certificate must move makes it difficult to design suitable controls. Moreover the need for certain manual operations, such as the review of signatures, tends to slow up the procedures considerably (Robbins, et. al., 1969, p. 32).

Additional emphasis should be given to the importance of these authors' statements about the difficulty of maintaining adequate control over the stock certificate and its movement. It will be shown that it is precisely this

difficulty of maintaining control which made the theft of securities so easy to accomplish.

The Stock Record Department

One other back office department, which is involved in the processes which are of interest to the tracing of the theft of securities, is the Stock Record Department. It is the depository for information from other departments. It is also responsible for maintaining an exact inventory of securities that the brokerage firm carries. Robbins, et. al. (1969), point out that the records which the Stock Record Department maintained did not always correspond with the records of the other departments, thus indicating that considerable amounts of securities were missing or stolen, or at the minimum, unaccounted for.

Summing up this discussion of paperwork flow and the stock certificate, it should be apparent that the flow of paper which accompanies any single sale or purchase of stock is considerably complex and outdated and creates numerous records and record keeping processes. Any of these can be subverted or manipulated if one has the express purpose to use this complex, outdated paperwork process as a means of stealing or misappropriating stock certificates.

Actions and Reactions of the Securities Industry to the Paperwork Overload

The various branches of the securities industry reacted to and initiated actions to reduce the paperwork overload.

Actions were taken by the individual brokers, the self-regulating associations and the federal regulatory agency. Each of these will be presented and discussed.

Actions Taken by the Individual Brokerage Firms

When the individual firms realized the proportions of this paperwork overload, they initiated numerous stopgap measures. But as Robbins, et. al., point out, some of the steps taken caused as many problems as they resolved.

> The immediate reaction of brokerage firms to the pressure exerted on their back offices was to hire more personnel. In many instances this was accomplished through raids on other firms; but such tactics merely shifted pressures within the industry without effecting any sort of cure. Indeed, within the raiding firm no easing of conditions may have occurred, because the errors often involved unmatched transactions between firms, and therefore operational sins of one company were visited upon others. For this reason, even those firms that anticipated operational problems and took measures to avoid them found themselves at the mercy of other firms that had failed to take similar precautions.
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> Efforts to attract people from outside the industry were common. An official of one firm in dire straits told how a management consultant organization was employed to help the firm 'come out from under.' The consultant responded vigorously by importing new personnel 'in trucks.' The main objective was 'to obtain healthy bodies,' and in one case, a new clerk did not even know how to use an adding machine. ...
>
> Virtually all firms sought refuge in heavy doses of overtime, but eventually reliance on this means of assistance had to be replaced. For one thing, wearied employees began to contribute increasingly to the pile of errors already accumulating at an alarming rate. Then again, overworked employees were more willing to quit not only the firm but the industry as well. ... Once the overtime habit was broken, it was hard to restore--it was easier to allow the paperwork to accumulate from day to day (Robbins, et. al., 1969, p. 37).

In addition to filling the back offices with inexperienced people, who perhaps made as many errors as they did

do accurate work, this massive hiring made possible, if organized crime was interested, the infiltration of the back offices with people who could be "controlled." One company's work force swelled from 650 to 1,000 people in less than a year. When testifying during Hearings (1969) before the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce of the House of Representatives, Robert Haack, then President of the New York Stock Exchange, stated that during 1968 NYSE member firms increased their staffs about 20 percent above the 1967 level by hiring about 25,000 employees that year. The evidence presented at the Hearings (1971) on Organized Crime and Stolen Securities indicate that among these 25,000 newly hired employees were some who had so called "connections" with organized crime; this "infiltration" will be discussed in Chapter IV.

The other major effort taken by the individual brokerage houses to solve the paper crunch problem was, belatedly, to automate the back office operations. This also created a number of unexpected difficulties in that the conversion was conceived of and implemented in haste (desperation), and this prevented needed time for planning and implementation of automation on the slow, step-by-step process that successful automation requires.

> ... It was this unplanned combination of the old and the new that cause many of the security industry's difficulties. Although impressive, automated equipment often was not programmed to integrate complete operational sequences. Therefore, manual methods were necessarily employed at

> crucial processing points, often jarring the proceedings. Moreover, due to the complexity of the back office, even computer specialists experienced difficulties in relating computer technology to brokerage requirements (Robbins, et. al., 1969, pp. 37-38, 55).

Actions Taken by the New York Stock Exchange

The other two major branches of the securities industry, the self-regulatory bodies and the Securities and Exchange Commission, also put forth major efforts to reduce the back office problems. The New York Stock Exchange became aware of the problem because of the increased number of customer complaints that it received and because of these submitted an operations questionnaire to all its member firms. Through this operations questionnaire it belatedly spotted floundering firms, and then imposed appropriate corrective action. One course of action was to adopt four new rules concerning trading and operations. Three of these rule changes pertained to sales, such as requiring member firms to take orders only from customers willing to accept and pay for partial delivers; these changes in the rules of selling were designed to reduce the paper work crunch of the back offices. The fourth rule change levied a charge for a firm's failing to deliver stocks to the purchaser or his representative within a specific time limit.

The Exchange also applied specific restrictions in individual members that experienced serious difficulties with their paper work, such as suspending approval of the hiring of and licensing of new sales representatives, and of new branch offices, and it imposed limitations on the trading of

individual firms. During 1968 approximately eighty member firms were placed on restriction, and in January, 1969, the Board of Governors passed a constitutional amendment that allowed the Exchange to fine member firms up to $100,000 for each persistent operational shortcoming in violation of the rules of the Exchange. Prior to the passage of this amendment, the Exchange could only fine or otherwise discipline individual members of the member firm.

It was reported in The Wall Street Journal of September 26, 1968, that Hayden Stonce, Inc., one of the nation's largest securities houses, was fined $150,000 for violations of the rules of the New York Stock Exchange, and it was noted that this was the stiffest fine ever imposed by the New York Stock Exchange on one of its members. The fine was for violations growing out of the firm's 1968 operational difficulties, and although this was the largest fine, it was considered just one action in a campaign being waged by the New York Stock Exchange against firms that could handle effectively the high trading volume to the investing public.

The most visible action taken by the New York Stock Exchange was to shorten the trading period. From the middle of June, 1968, until the close of that year, the Exchange operated only four days a week, being closed to trading on Wednesdays. In the beginning of 1969, the customary five day trading period was resumed, but one and one-half hours were

cut from the trading day, with closing time being at 2:00 p.m. rather than at 3:30 p.m.

The relief generated by this curtailing of the trading period is subject to much dispute. Representatives of the Exchange contend that the reduction in trading days and hours left more time available for and thus reduced the operational problems of the back office. A report prepared for the Committee on Commerce and Finance of the Committee on Interstate and Foreign Commerce of the House of Representatives (1971) presents a different view:

> Although 1968 had 12% fewer trading hours than 1967--due to the elimination of 26 trading days and shortening of 28 others--reported share volume reached a new record of 2.93 billion shares, an increase of 400 million shares--or 16%--over the preceding year. Significantly, on 25 days during the year, reported volume exceeded the 16.4 million share record which had stood since October 29, 1929.
>
> The considerable array of special rules and procedures aimed directly at alleviating the paper work problem gradually began producing the desired effects--although continued high share volume through the end of the year hindered even the most determined effort to whittle down the backlog (Committee on Commerce and Finance of the Committee on Interstate and Foreign Commerce of the House of Representatives, 1971, p. 17).

It is clear from the above, then, that although the period for trading was reduced, the amount of trading done during this reduced period of trading was increased; thus negating the proposed benefits to be gained by reducing the period of trading.

Actions Taken by the Securities and Exchange Commission

With respect to the paper work problems of the individual broker-dealers, the Securities and Exchange

Commission primarily relied upon the measures adopted by the various self-regulatory agencies; however, in individual instances it did take specific action in order to exert a curbing influence. In the spring of 1969 the Commission warned the stock exchanges not to extend trading hours further without first consulting with it. After the self-regulatory bodies had pinpointed the major problem areas, the Securities and Exchange Commission cooperated with them in investigating brokerage firms and in developing appropriate solutions to the existing problems.

> Within its own jurisdiction, the Commission did exercise unilateral action. In several instances, it interpreted anti-fraud rules in a manner designed to iron out operational wrinkles. Broker-dealers knowingly engaging in delayed transactions were ruled in violation. So too were broker-dealers who accepted orders without adequate facilities and/or personnel to promptly execute these transactions. The Commission also proposed a new rule (not yet implemented) that makes it unlawful for any issuer to offer a security without providing adequate registration and transfer facilities. Adding its weight to other self-regulatory agencies, the SEC took further action when it believed such measures were necessary; it brought private administrative proceedings against some firms, and introduced its own restrictions. It censured individual firms, and in extreme cases, it banned firms from trading due to serious record-keeping and/or net capital violations (Robbins, et. al., 1969, p. 50).

Along with the reactions of the broker-dealers, the exchanges, the Securities and Exchange Commission and the investing public (the ultimate victim of the paper work breakdown) had definite, if belated reactions, to the failures of the industry to process accurately stock certificates and related paper work.

> You'd buy a stock, pay for it, and then the broker would lose the certificate. And then he'd bill you again. And then you couldn't sell because nobody had any record that you owned the stock (The Wall Street Journal, September 10, 1970).

Because of these operational difficulties, the investing public became quite disenchanted with the service received from their brokers, and subsequently they became vocal in making complaints. The customary procedure was for the investor to complain first to the brokerage firm with which he was dealing. Then, if the errors were not remedied, he would usually take his complaints to one of the stock exchanges and finally to the Securities and Exchange Commission.

Table 2 shows the number of complaints received by the Securities and Exchange Commission from 1967 through 1971, and it is obvious that as the volume of trading increased yearly through 1968, so did the number of complaints.

TABLE 2

Number of Investor Complaints Received by the Securities and Exchange Commission, 1967-1971

Fiscal Year	Number of Complaints
1967	2,600
1968	4,000
1969	12,500
1970	15,000
1971	17,600

Source: U.S. Congress. House. Subcommittee on Commerce and Finance of the Committee on

> Interstate and Foreign Commerce. Hearings: Study of the Securities Industry. Publication Serial Number 92-37, 92nd Congress, 1st Session, 1971, Part 1, p. 97.

Robbins, et. al. (1969), break down the number of complaints received by the Securities and Exchange Commission during 1968 by quarters.

> Such data are not regularly reported in statistical form, but an SEC official indicated that during 1967 complaints numbered between 720 and 786 per quarter. In the first quarter of 1968 complaints amounted to 780; in the second quarter they leaped to 1,147; and in the third quarter, they hit a record high of 1,401. At this rate they amounted to more than 100 grievances per week, primarily concerned with delays in receiving stock certificates, dividend checks, and payments due from the sale of securities. This pronounced expression of public discontent undoubtedly was an important factor in stimulating the Commission to investigate conditions within the industry and to take positive action against certain companies (Robbins, et. al., 1969, p. 41).

As Robbins, et. al. (1969), point out, the most conspicuous indicator of the paper work breakdown was the failure of the broker-dealers to deliver the stock certificates due from the sale of securities to the purchaser. This is known as fails. In numerous articles appearing during this time about the paper work crunch, reporters for The Wall Street Journal included a standard paragraph defining and explaining fails.

> A fails is a broker's inability to deliver, within the required five business days, securities he owes other brokers. At the height of the industry's operational crush, the dollar value of fails on the books of Big Board member houses reached $4.1 billion last December 31 (The Wall Street Journal, September 8, 1969, p. 26).

Robbins, et. al. (1969), present a useful discussion of the fails situation that includes a table (Table 3)

showing how the problem sky rocketed as the volume of trading increased.

> To the public, the most conspicuous indication of the paper backlog was the story of 'fails'--securities that cannot be delivered by a broker within the five-day period provided for completion of a transaction. As far back as 1963, the SEC's Special Study of Securities Markets called attention to the potential danger of this problem. It specifically noted that 'fails' were caused by heightened market activity coupled with increased work loads in the back offices of broker-dealers as well as in the transfer process itself. It further indicated that many persons and organizations within the securities industry were concerned that late security deliveries would cause a loss of confidence among the investing public. Despite this warning and with a mounting awareness of the financial community's problems official data on fails was not compiled until April, 1968. As can be seen in the table below, fails were generally high during most of 1968; reached a peak at the end of the year; and then began to decline. Not until March, 1969, were they below the figure initially issued in 1968 (Robbins, et. al., 1969, p. 34).

> ... the very existence of a large and growing fails volume bears serious implications for the financial well-being of the securities industry. During peak periods, it is entirely possible that fails result from a series of inter-connected transactions: An individual may purchase shares through broker A who bought them through broker B, who, in turn, purchased them through broker C. When trading is particularly active, such a sequence may take place during the course of a single day. If the customer of broker C delays in delivering his certificates, one processing day may well turn into several before the transaction is finally completed. Moreover, if business pressures cause an error on one of the broker's books, months could conceivably elapse before the chain is repaired (Robbins, et. al., 1969, p. 35).

So as of December 31, 1968, $4.13 billion worth of stock certificates were listed as fails and had not been delivered to the proper place within the prescribed period of time. It was during this time, late 1968, that the New York Times suggested editorially to securities industry leaders that rather than closing the various exchanges one day per

TABLE 3

Fails-to Deliver

Year and Month	Billions of Dollars
1968	
April	$2.67
May	$3.46
June	$3.77
July	$3.67
August	$3.10
September	$3.08
October	$3.36
November	$3.27
December	$4.13
1969	
January	$3.21
February	$2.97
March	$2.48

Source: Sidney M. Robbins, Walter Werner, Craig G. Johnson and Aaron Greenwald, Paper Crisis in the Securities Industry: Causes and Cures (New York: Lybrand, Ross Bros. and Montgomer, 1969), Table 1, p. 43.

week or reducing the trading day by ninety minutes, the major exchanges should cease trading operations for one full week at the end of the year and let this time be used for member firms to restore internal records. Had this suggestion been adhered to (it was not), the broker-dealers, exchanges and investing public might have experienced an additional shock. Rather than locating and processing the fails (missing stock certificates), they might have discovered that the stock certificates could not be delivered at all because they had been stolen. This is clearly what the 1971 Hearings on Organized Crime and Stolen Securities before the Permanent Subcommittee on Investigations of the Committee on Government Operations of the United States Senate revealed.

Summary

Before turning to the disclosures made during the Hearings on Organized Crime and Stolen Securities, it is advisable to review what has been discussed in this chapter. The securities industry has been defined for the scope of this study. Also described have been the origins, purpose and history and the security industry as a whole, and the stock exchanges and individual brokerage firms have been examined. The role of the federal regulatory agency for this industry, the Securities and Exchange Commission, has been described and discussed.

Considerable attention has been given to the paper work operations entailed in the sale and purchase of stocks. Emphasis has been given to the importance of the certificate and the old fashioned way it is handled and processed.

In addition to the role of the stock certificate, the effect of the increased volume of sales and corresponding paper work increase which occurred after 1965 has been studied.

In concluding this chapter, it is again pointed out that in the late sixties, the securities industry was experiencing considerable operational difficulties, and at that time was particularly vulnerable to possible criminal activities.

CHAPTER IV

THE STEALING AND DISPOSING OF SECURITIES AND ORGANIZED CRIME'S ALLEGED INVOLVEMENT THEREIN

> Consider the perfect crime: it should be bloodless, afford a high yield, entail low risk, and defy instant discovery and hot pursuit. Naturally, the caper should be asthetically pleasing, and carry a light sentence or none at all upon conviction.
>
> A few thieves think they've stumbled on the latest in criminal chic. The take may have reached $50 million last year; the place was the financial world; the victims were banks and brokerage houses; the techniques involved the mysterious disappearance of all forms of securities. Losses were insured and hardly anyone was hurt. In brief, stealing securities comes pretty close to the perfect crime (Kremetz, 1971, p. 15).

From the presentation in Chapter III, it can be seen that during the late 1960's, the back offices of many securities brokers and dealers were in disarray. One additional example given by Robbins, et. al. (1969), will be used to illustrate how easy it was for brokerage firm employees (or anyone else of a disposition to) to walk out of a broker's office with securities which did not belong to him.

> Thus, the Cage manager of a major securities house wryly observed that during the paper crisis he measured the volume of certificates by the height of the pile accumulated. He referred to one day, in particular, when approximately four feet of stock certificates were received and only one foot was sent to the transfer agent (Robbins, et. al., 1969, p. 67).

In any office where the movement of valued stock certificates was measured in feet and in no other way controlled, the so-called perfect crime of stealing securities could not

be too difficult to accomplish if one was so disposed. When appearing at the Hearings conducted by the Permanent Subcommittee, Donald T. Regan, president of Merrill Lynch, Pierce, Fenner, and Smith gave a useful summary of the events leading up to the sizable thefts of securities. He explained that in earlier times the volume of business in the securities industry had been low and the level of sophistication criminals had with respect to converting securities to cash was correspondingly low. Then two events coincided.

> ... The first was a great increase in the volume of transactions in 1967, 1968 and early 1969. The second was a matching rise in the level of sophistication about securities on the part of criminals. Metaphorically, you could say that at the moment when the body was weakest, a new virus was introduced (Hearings, 1971, Part 2, p. 527).

In Chapter II, the existence of an encompassing organization with criminal intent was described and discussed. In Chapter III, the operations of the securities industry were analyzed. The fusing together of these two entities resulted in the wide spread theft and subsequent disposition of securities. Herein the mechanisms of theft and disposition will be presented and analyzed. The purpose of this chapter is to fuse together the information and resulting effects presented in the preceding chapters.

This discussion will open with a presentation of the scope of the problem. Evidence will be presented to illustrate the rather large losses incurred through the theft of

securities. It will be shown that the exact amount of loss is not known and may never be realized.

Following this, an attempt will be made to establish that, in fact, elements of organized crime were and are involved in these activities.

The different criminal acts involved in this activity will then be discussed. It is of interest to know there are two separate and distinct criminal acts: the actual theft and the subsequent disposition of the stolen securities. Hearing testimony revealed that these two criminal acts were not customarily committed by the same criminals, and each required special skills and knowledge.

Each of the criminal acts will be discussed and analyzed. In addition to there being two criminal acts, there are also several different types of thefts. The two primary means of stealing are thefts by securities industry employees and thefts from the United States mails; examples of each will be given.

Generally, there are four methods in which stolen securities can be disposed. They are: (1) the reselling of stolen securities through brokerage firms; (2) the using of stolen securities as collateral for bank loans; (3) the exporting of stolen securities to Switzerland and other countries where they are placed in banks and other financial institutions; and (4) the placing of stolen securities in insurance

company portfolios. Examples of each of these methods of disposition will be presented.

Running concurrently through this inquiry will be a discussion of the effect of these criminal acts of theft and subsequent disposition upon the securities industry.

Scope of the Problem

After 1965, the theft of securities greatly increased, and by 1968 and thereafter, the industry became alarmed. Subsequently the Senate Hearings were held. Abstracts of two charts presented to the Senate Subcommittee give some idea of the scope, in dollar amount, of the magnitude of the loss by theft of securities (see Table 4, p. 64).

Attorney General Mitchell informed the Subcommittee that during 1969 and 1970, $400 million of securities were stolen and not recovered. He was questioned by various senators as to the amount of the $400 million which was recovered, and he did not know the answer. Upon checking, he learned that that figure represented the amount that had been stolen and never recovered. He then surveyed the United States Attorney's Office and ascertained that during that period, fiscal years 1969 and 1970, federal arrests resulted in the recovery of approximately $50,261,000 of stolen securities. He also pointed out that during this same period, a total of approximately $7,000,000 of counterfeit securities were recovered as the result of federal action.

TABLE 4

National Crime Information Center (NCIC)
Stolen Securities Files

	Records Entered	
	1969	1970
U.S. savings bonds	24,366,722	$ 12,527,226
Treasury bills	25,140,000	22,928,460
Treasury bonds	15,702,050	6,944,998
U.S. savings bonds	202,575	242,470
Treasury notes	522,000	909,849
Other U.S. securities	6,639,705	1,528,510
Bonds	3,617,639	5,720,302
Debentures	67,100	767,280
Notes	966,192	27,080,512
Subtotal	77,820,383	78,649,607
Common and preferred stocks	98,009,498[1]	148,748,230[2]
TOTAL	175,829,881	227,397,837

Source: U.S. Congress. Senate. Permanent Subcommittee on Investigations of the Committee on Government Operations, Hearings on Organized Crime and Stolen Securities, 92nd Congress, 1st Session, 1971, Part 1, Exhibit No. 3, p. 64.

[1]The computation is based upon the figure of $44.80 which was the average price per share as of April 30, 1971. 2,187,712 shares times $44.80 equals $98,009,498, an approximation of the dollar amount of the losses entailed.

[2]The computation is based upon the figure of $44.80, which is the average price per share as of April 30, 1971. 3,320,273 shares times $44.80 equals $148,748,230, an approximation of the dollar amount of the losses entailed.

All available records indicate that the theft of securities was on the increase during the late sixties. It should be realized, however, that the actual size of the loss from stolen securities is not known because many brokerage firms did not report many of their losses to either law enforcement agencies or insurers for fear that the public would lose confidence in that particular brokerage firm. Several witnesses from the securities industry, testifying before the Subcommittee, stated that until the thefts reached such proportions, it was practically standard operating procedure to absorb the loss rather than report it. Consequently the actual extent of losses from securities thefts can only be surmised. Table 5 shows what was actually reported as lost or stolen to the New York City Police Department.

Organized Crime's Alleged Involvement With Stolen Securities

As emphasized in Chapter II, it is most difficult to define organized crime, and, consequently, it is even more difficult to establish organized crime's involvement in any specific criminal activity. The evidence presented to the Permanent Subcommittee, however, enables one to conclude with some degree of certainty that at least some well organized organization with criminal intent participated in some of the thefts and subsequent dispositions of securities. Three specific examples will be presented in order to tie together

TABLE 5

Breakdown of Reported Thefts and Losses of Securities Suffered by Brokers and Banks as Reported to the New York City Police Department

	1967		1968		1969		1970	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount
Brokers								
Thefts	12	$1,417,716	12	$ 8,337,440	65	$ 8,707,998	50	$13,173,566
Losses	17	3,988,400	19	4,328,850	20	4,453,050	27	13,214,462
Banks								
Thefts	5	1,937,163	9	806,805	17	16,073,249	4	4,473,500
Losses	1	903,000	4	1,525,000	5	11,398,314	15	7,729,838
Total Number and Amount of Thefts and Losses	36	8,246,279	44	14,998,095	107	40,632,501	99	38,591,366

Source: U.S. Congress. Senate. Permanent Subcommittee on Investigations of the Committee on Government Operations, Hearings on Organized Crime and Stolen Securities, 92nd Congress, 1st Session, 1971, Part 1, Abstracted from Table II, p. 45.

organized crime, as herein defined, and the theft and disposition of securities.

Admissions by an Organized Crime Figure

In the sixties, Joseph Valachi publicly admitted his involvement with organized crime; his testimony and The Valachi Papers, by Maas (1968), are widely quoted sources on organized crime. Currently Vincent Charles Teresa is following a similar course of action.

At some time prior to June, 1968, three U.S. Treasury bonds, totaling $300,000, were stolen from the New York officers of the Merrill Lynch, Pierce, Fenner, and Smith brokerage firm. An attempt was made to cash these bonds at the chasier's window of Caesar's Place in Las Vegas, Nevada. Mr. Teresa was convicted of being involved in the theft, interstate transportation and disposition of these bonds and was sentenced to serve twenty years in a federal correctional institution. Upon conviction, Mr. Teresa agreed to cooperate with federal law enforcement officials; his sentence was reduced to five years.

Mr. Teresa was granted immunity from further prosecution and testified before the Senate Subcommittee Hearings on Organized Crime and Stolen Securities on July 27, 1971. He stated that at that time he had been cooperating with federal law enforcement officials for the past sixteen months, and his testimony and cooperation had resulted in the conviction of some eighteen to twenty others, all believed to be connected with organized crime. Subsequently Mr. Teresa (1972) has

written a book, My Life in the Mafia, and both in it and in his testimony before the Subcommittee, Mr. Teresa (1972) describes his own involvement in organized crime and the operations thereof.

With respect to stolen securities, Mr. Teresa testified that he probably looked at $25 to $30 million of stolen securities, and he personally sold or hypothecated over $3 million of stolen securities. Mr. Teresa also estimated that of the $25 to $30 million of stolen securities that he saw, over $3 million came from "inside" jobs where employees of brokerage firms had stolen from their employers. It is clear from his testimony and from the questions asked by the participating senators, that there is no doubt in any of their minds that organized crime does exist and was or is actively involved in the theft and disposition of stolen securities.

Personal Knowledge

The Hearings (1971) on organized crime and stolen securities began on June 8, 1971; the first witness to appear before the Subcommittee was the then United States Attorney General John Mitchell. The following is an excerpt from his opening statement in which he gave several examples of organized crime's involvement with stolen securities.

> ... A third example is the case of Harry Riccobene[3], who was a prime target of our Philadelphia Organized Crime Strike Force and a close associate in the organized crime 'family' of Angelo Bruno. Riccobene, along with John Scially and Joseph Zavod, sold a stolen $500,000 U.S. Treasury bill to an Indianapolis, Inc., insurance company for which they received $150,000 and 87,500 shares of corporate stock. All three were convicted.

Wide Distribution as an Indicator of Organized Crime's Involvement

The third example to be cited to demonstrate organized crime's involvement in stolen securities involves the theft of $13,194,000 in U.S. Treasury bills from the Morgan Guaranty Trust Company of New York. The executive vice-president of the bank described the theft and the subsequent attempts to dispose of the securities. Over a period of several days in October, 1969, these U.S. Treasury bills disappeared from the receiving section of the custody department of the bank; they were not in a vault at that time. The bank's internal search for the bonds was fruitless, and the losses were reported to numerous law enforcement agencies and financial institutions. Mr. Rohlf states that how the theft was perpetrated could not be determined, and for a time it was thought that the bonds might have been inadvertently destroyed. Alter, however, attempts were made to cash these stolen bonds, and it was concluded that they must have been stolen. Mr. Rohlf lists the places were attempts to dispose of the bonds were made.

> Mr. Rohlf. Bills totaling $10,360,000 have been recovered in New York City, Philadelphia, Los Angeles, Seattle, Kansas City, and several other points in the United States, and in Nassau, Sweden, Switzerland, Netherlands Antilles, Mexico and Germany.
>
> Bills totaling $723,000 and involving persons who claim to be innocent holders in due course have been located at such points as Brooklyn and Springfield, Mass.; Irvington, N.J.; New York City; and Albany, N.Y. ... (Hearings, 1971, Part 2, p. 495).

Kremetz (1971) contends that the fact that the commission of these thefts from Morgan Guaranty Trust Company

occurred during the final game of the 1969 World Series, during which much of New York City was in delirium because the "Miraculous Mets" were World Champions, and the fact that all of the stolen U.S. Treasury bills matured within six months strongly indicates premeditation and planning and therefore, organized crime.

An even stronger argument for linking organized crime with this unsolved theft is the number of places in at least three continents and more than six countries where attempts were made to cash or otherwise dispose of these securities. There must have been some organized network for the distribution and disposition of these stolen Treasury bills. New York County Assistant District Attorney Gross contends that the international connections of organized crime which provide for the global distribution of narcotics also provides the network for distribution and disposition of stolen securities. This will be explored more fully later in the study.

The Theft of Securities

In discussing the theft and disposition of securities, several points of clarification are necessary. The first is that there must be two separate discussions, for, in actuality, there are two separate but related criminal acts, each dependent upon the other. The first criminal act, naturally, is the actual theft of the securities. In this area New York County Assistant District Attorney Murray J. Gross advises

that both what he calls the amateurs and the professional thieves operate. The amateurs are defined as those who do not make their living by thievery, but are customarily securities employees who for various reasons steal securities from their employers. The professional thief is one who has made his living by stealing and is assumed to be "connected" with organized crime.

The second criminal act is the disposing of the stolen stock certificates for profit. It is in this area that organized crime is alleged to be dominant. Prior to the late sixties, theft from securities brokers and dealers was not rampant because there were not many places where the stolen securities could be disposed of. It is widely believed that organized crime filled this void by providing the ways and means to dispose of the stolen certificates.

An admitted and convicted dealer in stolen securities, after being granted immunity from further prosecution, pointed out to the Subcommittee that until the late sixties, mail thieves would often burn stock certificates and other paper documents whose value when negotiable was quite high because they had no way to dispose of them. As will be shown subsequently, by devising new means of disposing of stolen securities, organized crime acted as a catalyst in the theft and disposition of stolen securities and thus greatly increased both the demand and consequently the supply. But first, the actual theft process will be studied.

With respect to the theft of securities, New York County District Attorney Gross summarized for the Subcommittee the situation as it first existed and then how it was in the late sixties.

> The success of these endeavors (the theft and disposition of securities by organized crime personnel) became so widely known, that at least, in the area of actual theft of securities organized crime is now faced with stiff competition from what I would call amateurs.
>
> I say only the theft because organized crime has a virtual monoply on disposition of the stolen securities. Rather than jump ahead to the disposition let us examine the theft itself (Hearings, 1971, p. 73).

Employee Theft

With respect to employee theft, Norman Jaspan (1972), a management consultant, stated that employees steal from their employers more than $10 million a day in cash and merchandise or more than $3 billion a year. He added that this means that approximately 15 percent of the price of what customers pay for goods and services goes to cover the cost of dishonesty.

Other experts in the field of employee thievery state that uncovering employee theft is a relatively simple task. The real trick is to keep it under control once it is discovered. The second part of that statement is valid for the securities industry, but based upon the Morgan Guaranty Trust example, the first part of that statement may not apply to securities employee thefts due to the peculiar nature of that business. McClintick (1971) advises that experienced investigators in this area dispute those who blame the "declining morality in American society" as the reason for the rapid

increase in employee thefts. The investigators interviewed say that dishonesty is mostly a product of being offered the chance to be dishonest. They contend that most companies are robbed by employees because of sloppy supervision, increased pressure on the job and a failure to enforce rules already published. Based upon the events that took place in the back offices of the brokerage houses during the late sixties, this would appear to be quite applicable to the securities industry.

Personnel Problems Peculiar to the Industry

Due to the peculiar processes and practices of brokers and dealers in securities, there is one particular time at which the broker-dealer is vulnerable to thefts by employees. This is when the stock certificates are being transported physically from one part of the back office to another, or from one brokerage house to another, or from a brokerage office to or from a transfer agent. The Chairman of the Board of Merrill Lynch, Pierce, Fenner, and Smith pointed this out to the Subcommittee:

> Mr. Regan. The moment of greatest weakness in the transaction process comes when securities are physically transferred. In our New York Office we constantly change the assignments of the people in the transfer area, so that no one employee is consistently counting or moving the same security. We count the securities in transfer daily, and take steps to make any missing securities non-negotiable (Hearings, 1971, Part 2, p. 528).

With respect to employee thefts within the securities industry, New York County Assistant District Attorney Gross informed the Subcommittee that he had been able to identify

three profiles of employees who stole stock certificates from their employer.

> Mr. Gross. The main motivation of the thief is as always profit. We should view the Wall Street thief's profile as one of three types.
>
> The heretofore honest employee who steals quite independently of any outside influence. Be it whim or some vague idea of vast profits, he steals (Hearings, 1971, Part 1, p. 73).

This profile would correspond with what Jaspan (1972) describes when he states that many thefts from employers by employees are not really done for profit, but are committed out of spitefulness or frustration. For the securities industry, frustration must have been rampant during the hectic days of the back office paper work crunch.

> Mr. Gross. The second type and what is probably most prevalent is the employee who is induced to steal either through fear or the promise of profit by the underworld.
>
> There may be direct threats to the employee of bodily harm to him or his family arising possibly out of a gambling or loan shark debt. Bookies and loan sharks give free and easy credit on the street (Wall Street) (Hearings, 1971, Part 1, p. 73).

Earlier in his prepared statement, Mr. Gross had discussed organized crime's entry into securities thefts and to include intimidation and manipulation of securities industry employees.

> Law enforcement was somewhat successful but more important it learned that organized crime had entered this new area. Organized crime learned from its earlier blunderings. They came to Wall Street, with their same 'bag of tricks,' and they found that they could use the traditional techniques that are so successful in other areas of criminality, extortion, robbery, intimidation, counterfeiting, embezzelment, simple theft and even arson, were more than able to breach the flimsy fortress of Wall Street security (Hearings, 1971, Part 1, p. 73).

In discussing the securities industry's back office paper work overload, Robbins, et. al. (1969), point out that for working in a harsh, chaotic environment under severe pressure, employees in the back offices for the brokerage houses should have received compensatory wages, but they did not. For 1966 the annual earnings of registered representatives (stock salesmen) averaged $15,000, plus bonus, while the average salary for back office employees was $6,500, plus a smaller bonus. In 1968, the average salary for outside messengers was $70.00 per week, and for Junior Cage Clerks it was $100.00 per week. These are but two of the jobs where the occupant is most likely to be involved in the physical transfer of the stock certificates. It does not seem at all unreasonable that this type of employee was especially susceptible to pressures to steal from his employer, especially when this type of employee was handling stock certificates worth millions of dollars. Doyle and Kappstatter (1972) describe an instance where an employee in this job category was vulnerable and apparently succumbed to the pressures which allegedly came from organized crime.

> The head runner for a Wall Street brokerage house, in debt to loan sharks, calmly walked into the office main vault twice this month and removed close to $1 million in negotiable stocks, police reported yesterday after the arrest of the runner and two men to whom he allegedly was handling over the stocks.
>
> The head runner for CBWL-Hayden S one, Rocco Voglio, 27 of 17637 E. Second St., Brooklyn, police said, was $1,100 in debt to loan sharks and rapidly falling behind on his payments (New York Daily News, 1972, p. 28).

According to Assistant District Attorney Gross, the third type of thief who steals from his brokerage house employer presents the most troublesome situation for the broker; this is the plant of organized crime.

> The third and perhaps the one potentially most harmful is the employee placed in his position by the underworld for criminal purposes.
>
> Organized crime operating through an employment agency places budding criminals with falsified references in stock houses in New York and other cities. It is of no great consequence the position in which they are employed because they will either have direct access to the securities or the opportunity to recruit other employees or as in one of our cases he was able to 'finger' another employee, a messenger, and set him up for a robbery.
>
> One informant, who has previously stolen securities, told me that he was sent to a Chicago stock house by an employment agency under an assumed name and with false credentials for the express purpose of stealing.
>
> Most often the thefts are simply taking the securities and hiding them on their person. Depending on the laxity of the internal security of the house the employee could, as in a recent case, successfully remove 2 1/2 million worth of securities by carrying them out in his attache case (Hearings, 1971, Part 1, p. 74).

As was noted in the last chapter, during the paper work overload, a tremendous hiring effort was put forth by the securities industry, and in one year alone, 1968, more than 25,000 new employees were hired. It seems apparent that among these newly hired were plants of organized crime.

Brokerage employees were not used only, however, to steal securities. Mr. Teresa advised the committee members that he used a brokerage employee to ascertain whether the industry knew that certain stock certificates had been stolen. If the industry knew, the certificate numbers would be on some type of "hot stock" sheet. If not, Mr. Teresa and others

would be free to dispose of the stolen securities. Mr. Teresa stated that he paid anywhere from $50 to $100 for such inside information, and he believed that at the time of the hearings other criminals were still utilizing insiders.

Mail Thefts

Employee thefts, then, constitute one source of stolen securities. But according to some of the witnesses appearing at the Hearings, securities employees were not the only, or even the primary, source. Both New York Assistant District Attorney Gross and convicted felon, Vincent Teresa, testified that the primary source of stolen securities was through stealing from the U.S. mails, particularly at airports.

Similar to the theft of securities from the brokerage firms themselves, the stealing of mail from airline shipments and other vulnerable places was not considered a serious problem until after 1965. As in securities thefts, the alarm over mail thefts was not sounded until well after the situation had reached crisis proportions. It is also interesting to note that the increase in mail thefts parallels a significant change in the way first class mail was transported.

When testifying before the Senate Subcommittee, William J. Cotter, Chief Postal Inspector, briefly outlined the history of mail transportation and security, and he describes the change in the method of transporting mail. He stated that security had always been of key importance to the U.S. Postal Service, but the tremendous increase in the volume of mail had

caused many problems in protecting it from theft and loss. Another factor was the decision to shift first class mail, including registered mail, from rail transportation to air transportation.

> Mr. Cotter. Consequently the volume of mail carried by air increased from 275 million ton miles in fiscal year 1966 to 585 million in fiscal year 1970, an increase of 112 percent. ...
>
> It became evident by the early fall of 1967, through mail loss reports and other intelligence that pouches containing registered mail were being singled out for theft at J.F. Kennedy International Airport, ... and subsequently at other airports about the country.
>
> ... To summarize, from 1967 to 1970 major criminal assaults were successfully made on mails during transit handling at certain major airports.
>
> A total of approximately $76 million in terms of securities, jewelry, travelers checks, and other valuables are reported by mailers as having been stolen. The major portion, over $71 million, was in the form of securities, most of which were in so-called non-negotiable form. ...
>
> Our investigations indicate that perhaps 90 percent of the airport mail thefts that have occurred since July, 1967, are attributable to a loosely knit group of seven hard-core recidivists, ... operating periodically at Kennedy, and at other times, fanning out to the other airports about the country (Hearings, 1971, Part 1, pp. 102-103, 105, 121).

In reviewing the testimony before the Subcommittee Hearings concerning mail thefts, two different viewpoints become apparent. One is the official viewpoint that there was a problem, it became serious, the security establishment became aware of the problem and resolved it through increasing standard security measures and devising new ones, such as the containorized convoy means of transporting mail from terminals to airplanes.

The second view is from the viewpoint of the criminal. Subsequent to being convicted of some federal mail crimes and

to being granted immunity from further prosecution, one of the seven principle mail thieves named by the Chief Postal Inspector appeared before the Subcommittee and became one of its star witnesses and experts on mail thieft. His credentials for being an expert on mail thefts at airports are impressive. Mr. Cudak explains to the Subcommittee his background and his entry into the mail theft business. At the time he testified, in 1971, Mr. Cudak was twenty-nine years old and acknowledged that much of his youth had been spent in state assigned foster homes and youth reformatories.

Mr. Cudak testified that he was released from prison in March, 1968, worked as a carpenter until September of that year, and at that time answered a newspaper ad placed by Northwestern Airlines for ramp men. He falsified his employment application.

> Mr. Cudak. Within 3 days I noted the laxity in security for value boxes of Railway Express and from Air Freight. Shortly thereafter, I stole something from Air Freight, and that was the beginning of my career as a thief in airports in New York City and elsewhere. I operated for almost 4 years.
>
> Between that first theft from Air Freight and my return to prison in September, 1970, I estimate conservatively that my partners and I systematically stole from Railway Express, Air Freight, and both regular and registered mail, approximately $100 million in stocks, bonds, jewelry, cash, furs and other valuable items (Hearings, 1971, Part 1, pp. 209-210).

Mr. Cudak testified that he and his associates robbed the mails approximately 125 times. Once they stole an entire truckload of first-class mail and parcel post packages. He

stated that all this was possible because the security at most airports was quite lax.

> Mr. Cudak. At most airports a person who put on a pair of coveralls and wore a plastic helmet or ear mufflers such as airport personnel use was not questioned and could move about the airport without restriction. ...
>
> Airmail bags, including registered mail bags, are unloaded from the planes and dropped in unguarded open areas known as mail transfer points, or sometimes they are left on baggage trucks. Registered mail bags are usually put inside other airmail bags.
>
> You can easily distinguish them from regular mail bags by touching them to find whether you have a double bag. Anyone dressed as a ramp man or airline employee can come along and grab any or all of the bags without being questioned (Hearings, 1971, Part 1, pp. 210-211).

The staff of the Senate Subcommittee interviewed Mr. Cudak extensively prior to his appearance before the Subcommittee in executive session and prior to the public hearings. During these interviews, Mr. Cudak admitted to or claimed to having committed a number of mail robberies and thefts. Staff members attempted to verify his contentions by check claims made upon the U.S. Postal Office Department. Of the 125 robberies claimed to be committed by Mr. Cudak, the Subcommittee Staff obtained the records of eighteen and for fourteen of these, compared the items Mr. Cudak claimed to have stolen with the items on the Post Office reports that were written from information which could have been known previously only by the person who mailed the shipments and by the postal officials who processed the claims.

Thus Mr. Cudak's claims were fairly well verified. The senior staff investigator noted that it is important to realize that the amounts of the claims filed with the Post Office

Department do not represent the true value of the losses suffered by the claimants who often undervalued their statements in order to reduce the registering fees.

From the information given by Mr. Cudak and verified through postal records, the Staff Subcommittee prepared a table to show the magnitude of loss from the thefts committed by Mr. Cudak and his associates. Table 6 is presented here for the same reason; it is important to note especially the amount of stock certificates, etc., that he is alleged to have stolen.

An analysis of the table reveals that approximately 96 percent of the total value of all articles reported lost or stolen by mailers were stocks, bonds, bills and notes. Mr. Cudak was asked by a member of the Subcommittee to estimate what proportion of the articles taken during his thefts were securities. He replied that it would be between 90 and 95 percent. He also explained that in his dealings with fences after his first few thefts, he received very little for securities, but the sophistication of the fences with whom he dealt increased as their supply of stolen certificates was replenished and increased by Mr. Cudak and his associates. Mr. Cudak stated that at first he would receive nothing, or at the most two points (percent of face value of certificates), but after this business was better established, he and others would receive up to 15 percent of face value.

STAFF STUDY OF 14 MAIL THEFTS INVOLVING ROBERT F. CUDAK, COMPILED FROM RECORDS PROVIDED BY THE U.S. POSTAL SERVICES

DATE	STOCKS	BONDS BILLS NOTES	JEWELRY	CASH & MISC.	TOTAL VALUE AS REPORTED BY MAILERS	NO. OF ARTICLES	NO. OF CLAIMS
09/13/67	$ 2,152,499.00	$ 122,500.00	$ 141,667.12	$ 1,459.84	$ 2,418,125.96	141	46
09/20/67	3,398,344.13	500.00	64,154.10	96,842.71	3,559,840.94	402	95
10/19/67	1,817.06	28,300.00	24,292.00	63,238.00	117,647.06	30	28
11/30/67	132,615.00	5,000.00	1,736.65	1,200.00	140,551.65	28	9
12/05/67	169,807.00	----------	29,579.86	7,089.32	206,476.18	---	40
12/12/67	675,721.00	248,146.25	35,208.50	1,478.50	960,554.25	66	27
05/15/68	18,602.00	----------	6,117.00	17,000.00	41,719.00	17	12
06/13/68	19,689,883.00	1,724,000.00	----------	70,500.00	21,484,383.00	68	16
10/16/68	2,000.00	----------	70,013.17	1,170.00	73,183.17	56	40
11/23/68	1,975,322.00	102,500.00	29,186.00	102,490.00	2,209,498.00	---	---
01/02/69	754,759.00	1,062,000.00	835.00	173,000.00	1,990,594.00	139	36
08/04/69	578,080.00	205,000.00	49,665.72	23,395.65	856,141.37	314	69
01/08/70	156,900.00	196,000.00	212,538.00	----------	565,438.00	39	15
02/04/70		5,000.00	153,780.00		158,780.00	6	6
TOTALS	29,706,349.19	3,698,946.25	818,773.12	558,864.02	34,782,932.58	1,306	438

SOURCE: U.S. Congress Senate Permanent Subcommittee on Investigations of the Committee on Government Operations, HEARINGS on organized crime and stolen securities, 92nd Congress, 1st Session, 1971, Part 1, p. 213. Footnotes omitted.

New York County Assistant District Attorney Gross disagrees somewhat with this estimation of the percentage of the face value of the securities received by the thief. He testified that the thief received around 5 percent, and he also stated that there is considerable haggling and bargaining between the thief and his fence.

The Disposition of Stolen Securities

With the theft of securities explained, and the profits for the thieves mentioned, the question which next arises is, if the thief is getting only 2 to 15 percent of the face value of the securities, who is making the bigger profits, and how is he marketing these stolen securities? Apparently, this is where organized crime enters and dominates the picture. Once again, as has historically been its function, organized crime is providing a service for those interested in participating.

Several times earlier in this study, it has been mentioned that organized crime's prime function in the theft and disposition of securities has been in the disposition area, but that statement bears repeating for emphasis. The Permanent Staff of the Senate Subcommittee did considerable research prior to the public hearings, and during this period, they interviewed a number of criminals who participated in the theft and disposition of securities, and they interviewed experienced law enforcement personnel who handled securities theft cases. From this information they prepared a chart to show the main

targets of the thieves who steal securities and the pattern of converting these stolen securities into cash and other assets. That chart is reprinted here as Chart 1; it serves both as a summary of what has been presented up to this point and as graphic illustration of the ways and means of disposing of stolen securities.

Methods of Distribution

Two very experienced dealers in stolen securities admitted to the Subcommittee that they were "connected" with organized crime. After being convicted of certain federal crimes pertaining to the disposition of stolen securities, they were granted immunity from further prosecution and testified at various criminal proceedings against other dealers in stolen securities. They also testified before the Permanent Subcommittee. Their testimony offers a useful example of how stolen securities are disposed. One of these men also defined "connected" with organized crime.

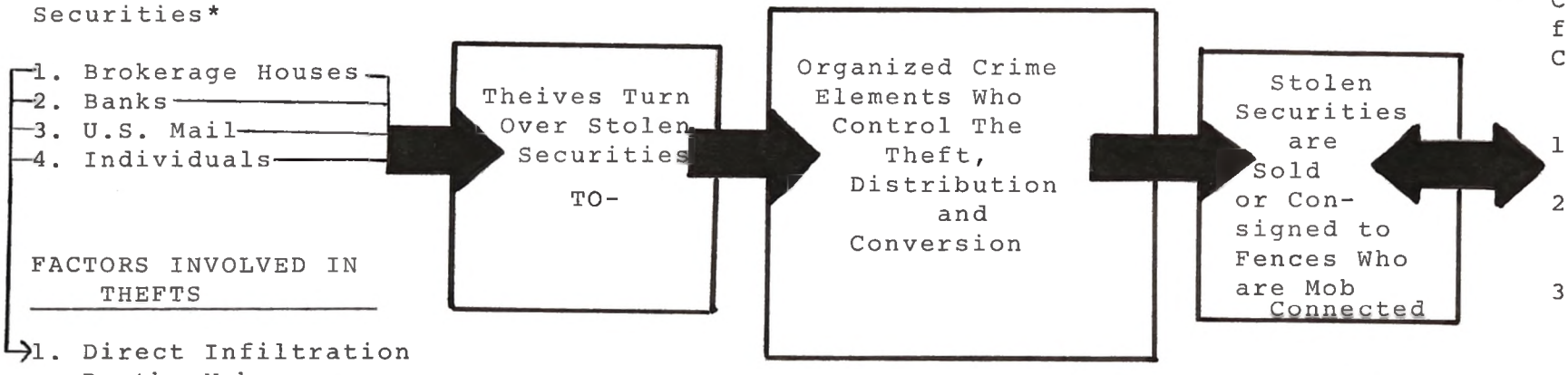
> Mr. White. The term 'well connected' indicates that a man is either a member of or closely associated with organized crime elements, and he therefore has influence and power as well as connections (Hearings, 1971, Part 3, p. 647).

In an interchange with Senator Percy, Mr. White clarifies the function performed by organized crime in the disposition of stolen securities.

> Mr. White. To try and answer your question, you take the area of stolen and counterfeit securities first as an illustration on its simplest level. Here you have a thief that goes in and steals this. I have spoken to dozens of them. As far as he is concerned, that is a piece of paper. I have spoken to people who burned stacks of securities

PATTERNS OF ORGANIZED CRIME

Perpetration of Thefts and Conversion of Securities



FACTORS INVOLVED IN THEFTS

1. Direct Infiltration By the Mob
2. Persons Under Pressure To Steal Securities
   A. Gambling Debts
   B. Loansharking Debts
   C. Narcotic Addiction
   D. Strong Arm
3. Theives Who Depend On Mob For Conversion

* Securities which are stolen include corporate stocks and bonds and U.S. notes and bonds. These securities are either in "street names", bearer instruments or in name of companies or individuals.

> because what does a thief who breaks into a house or something of that nature where a man may have a million dollars worth of securities know about it? What will he do about it? He hasn't the vaguest idea. What is a printer going to do with counterfeit securities? He will make wallpaper out of it because he can't do anything with it. In this thing you have to have somebody to act as a catalyst. The catalyst is the organized crime procurer because he knows the people that are stealing the stocks and he has the contacts on the other side to dispose of these securities. He may not himself be able to do it, but he certainly knows the people that can do this (Hearings, 1971, Part 3, p. 681, emphasis added).

With respect to the actual disposition of stolen securities, the other immune witness testified as to the methods used.

> Mr. Wuensche. I have personally used the following methods to convert stolen securities to cash.
>
> 1. I have resold stolen securities through brokerage firms.
> 2. I have placed or caused to be placed stolen securities in banks as collateral for loans.
> 3. I have personally taken stolen securities, especially U.S. Treasury notes, outside the United States to Switzerland, and other countries where they were placed in banks and other financial institutions.
> 4. I know of situations where stolen securities were placed in insurance company portfolios, both inside the United States and abroad (Hearings, 1971, Part 3, pp. 844-845).

Other witnesses before the Subcommittee, both dealers in stolen securities and authorized representatives of the brokerage houses and other financial institutions, confirmed that their four methods were the prime means of disposing of stolen securities. Examples of each of these methods will be presented to show how the stolen securities are disposed of and organized crime's involvement therein.

Selling Stolen Securities Through Brokerage Houses

Countless examples of each of these methods exist, especially the first two. Rather than cite a successful example of the first method of disposition, reselling stolen securities through a brokerage firm, an unsuccessful example will be cited. This is being done to illustrate not only the means of disposition, but also to show that after being taken advantage of so many times, the brokerage firms did become concerned about this problem and consequently initiated action to prevent or reduce the availability of this method of disposition. The witness is the Chairman of the Board of Merrill Lynch, Pierce, Fenner, and Smith, Inc., the largest brokerage firm in the United States.

> Mr. Regan. Any Merrill Lynch employee who has reason to suspect that anything is wrong has a personal responsibility to hold suspicious certificates and to call our protective services department. The department investigates promptly.
>
> Recently we have had some indications of the effectiveness of these methods. A customer of Merrill Lynch's office in Rome tried to sell through one of our branch offices in New York City some $80,000 worth of stock registered in the name of another firm. Dissatisfied with the proof of ownership, the assistant manager of the office called protection services. The sell order was refused. We found later that the stocks had been stolen from another broker.
>
> In another recent case, 2 weeks ago, a customer, acting through his lawyer, tried to sell through Merrill Lynch 6,000 shares of IBM registered in the name of another firm, and having a total value of almost $2 million. Again there, the preventive system worked. It turned out that the securities had been stolen. We informed the FBI, and arrests were made (Hearings, 1971, Part 2, p. 528).

Subsequent to making the above statement, Mr. Regan was asked why Merrill Lynch's employees had suddenly become so

conscious of the possibility that stocks presented to be sold may be stolen. He explained that it was because the company, as part of its newly created protective services program, required all new employees to be instructed in the problems of stolen securities and how to recognize them. Mr. Regan also pointed out that this program appeared to be working since the employee who stopped the sale of the 6,000 shares of IBM had been employed by Merrill Lynch less than a year. Mr. Regan also emphasizes that this was significant because a new employee does not customarily make many big commissions, so his refusing of a sell order of 6,000 shares of IBM is a sign of both awareness and self-sacrifice; thus the program must be having an impact.

Earlier in his testimony, Mr. Regan acknowledged that from 1965 through 1970 there had been three major thefts from Merrill Lynch, totaling about $2.4 million in value, and the company's average annual total of unrecovered thefts for this period was about $250,000 per year. But he did not indicate what dollar amount of stolen securities had been resold through Merrill Lynch offices. However, the fact that a separate department of protective services (headed by a former FBI agent) was created in 1969, and the fact that as a part of this program all employees received instructions on the need to be alert for persons attempting to resell stolen securities, appears to indicate that the reselling of stolen securities through the brokerage houses was a serious problem. Mr. Regan did recount

two unseccessful attempts to resell stolen securities through brokerage firms. Neither the Subcommittee nor the public will know until much too late of the successful attempts of re-selling stolen securities that have occurred or will occur in the future.

Using Stolen Securities as Loan Collateral

The second method of disposition listed by Mr. Wuensche is the placing of stolen securities in banks as collateral for loans. This method is, according to evidence presented to the Subcommittee, the most popular and perhaps easiest method of disposition. In fact, the evidence reveals that this method is so easy and so prevalent, that all banks probably need to check their loans to ascertain if the collateral presented is either stolen or counterfeit securities. Excerpts from Mr. White's and Mr. Wuensche's testimony will be presented to illustrate this method.

In this aspect of the discussion, stolen securities and counterfeit securities are considered synonomous, as the uses thereof and means of distribution are the same. Special attention should be paid to the commentary on and explanation of "friendly" banks.

Mr. White described several instances where stolen or counterfeit securities were used. In one instance. Mr. White used certificates in the name of Seaboard Airline Railroad, Inc.; this stock was worthless. However, the name of this company is almost identical to Seaboard Airlines

Railways, Inc., a firm which was not defunct and was listed on one of the major exchanges. Through a contact in Walston and Company, they obtained signature guarantees which indicated the stocks were legitimate. Mr. White emphasizes the importance of getting this signature, one which can be given only by higher level officials of the company. The criminal acts would not have been perpetrated without such a signature. The worthless stocks were then used as collateral to obtain loans from banks in Los Angeles and New York. Over $100,000 worth of certificates were used, and Mr. White realized a net profit of more than $10,000.

In 1969 Mr. Wuensche assisted in obtaining a collateral loan of $95,000 from the Long Island Trust Company, which was secured by a stolen Federal National Mortgage Association Bond valued at $100,000. He also testified to bank loans being made with stolen securities used as collateral from banks in Miami, Florida, New York, New Jersey and Pennsylvania. The fraudulent loans he discussed totaled over $5 million. His concluding remarks to the Permanent Subcommittee give some idea as to the scope of this method of disposing of stolen securities.

> Mr. Wuensche. ... Mr. Chairman, I could continue citing situations for a long time. I have been involved in stolen securities traffic for better part of 10 years. To reduce to writing everything that I know on each specific deal would require many, many pages and much research and recollection to corroborate just a small portion of what I know about this illicit traffic (Hearings, 1971, Part 3, p. 852).

"Friendly Banks." These comments by Mr. White and Mr. Wuensche reveal an interesting sidelight to the disposition of stolen securities and also bring to mind a statement made by an earlier witness appearing before the Subcommittee. The witness was commenting upon the motives of both these criminals and bankers that deal in stolen securities, and he pointed out that it is impossible to cheat an honest man or one who is not motivated by personal greed. In other words, many of these bankers and others who accepted the stolen securities, either knowing or suspecting that they were stolen, were as guilty of criminal acts as those who had stolen them in the first place. Indeed, both expert witnesses acknowledge that they were greatly facilitated in their dealings by representatives of what they termed "friendly" banks.

Both Mr. White and Mr. Wuensche testified as to the existence of "friendly banks." Mr. White explained that a bank officer may have any number of loan applicants to select from, and he usually is going to make the loans where, if he is "friendly," to the people who are friendly with him. When asked why a banker would make questionable loans, Mr. White replied that it was done for profit. He added that the banker may get cash in some instances, and stock certificates in others. Each situation is a unique and negotiated circumstance, according to Mr. White. Senator Allen asked Mr. White about the dangers that the banker will be exposed for

having made illegal or ill-advised loans. Mr. White replies:

> Mr. White. ... Their primary purpose is to be in a position to protect themselves, you see, in the event of a problem, to have a story. In other words, Senator, nobody is going to come forward and say, 'Yes, I took $5,000 to grant this illegal loan.'
>
> He has to have a story ready to tell that makes some sort of sense. In other words, in the transaction I described where Bankers Trust lent $50,000 against a rigged market situation, that banker is not going to come into any place and say that he got $7,500 to make that loan. But the facts of the loan to anyone who knows banking procedure in any prudent situation--even if it was a speculative situation--would preclude him making that loan under the circumstances.
>
> There was no procedure, there was no diligence, there was no norm. It was totally out of the norm of the banking situation. That unto itself speaks for itself (Hearings, 1971, Part 3, pp. 748-749).

When questioning Mr. Wuensche, Senator Percy follows up this discussion by attempting to find out how friendly bankers are located. Mr. Wuensche implied that "friendly bankers" can be found most anyplace, and that all the criminal has to do is look. He further advised that when looking for "friendly bankers," it is easier to do business at outlying branches of a large bank, because it is easier to make a connection at a branch than it is in the main office. He also offers some observations on the extent of "friendly banks," and the obtaining of a "friendly banker" enhances the acquisition of entire banks by criminal elements.

> Mr. Wuensche. From my own personal knowledge there are situations where the banks are owned, indirectly, by members of organized crime, that the people fronting the ownership and the top officers of these institutions are actually figure heads for organized crime.

> They don't make a move without first consulting someone else. This has become more and more prevalent in the last 10 years, both banking-wise, insurance company-wise, and any other financial type of an institution.
>
> There are so many of them that it would really shake you in your boots. You would wonder why the dollar is so depressed as it is in Europe and everywhere else. These people are just as bad as the thieves on the street. They have a price and they take this price and they extort you in every which way that you want to go (Hearings, 1971, Part 3, p. 863).

Mr. White related one instance to the Subcommittee that reveals how easy it was for those who had the skills to develop a friendly bank. He stated that he was instrumental in making a loan of a hundred and some odd thousand dollars from the Wheaton National Bank, Wheaton, Illinois, using counterfeit securities. Additional testimony from bank representatives reveals that a member of the board of directors who was on the loan committee telephoned the lending officer and the loan was expediated and made in less than two working days without a formal loan application being filed or without the routine credit checks being made, because a board member made that telephone call. The board member who made the call testified that he did so at the request of a man he had played golf with several times at his country club. Further testimony revealed that the bank board member's golfing partner was very well connected with organized crime, and allegedly belonged to this country club for the sole purpose of developing business and banking connections. Mr. White described this as an almost classic example of how organized crime gets into banks.

Exporting Stolen Securities

The third method cited by Mr. Wuensche as being used by organized crime figures to dispose of stolen securities is to transport the securities to countries outside the United States and dispose of them through foreign banks and other financial institutions. According to Mr. Wuensche, this was the most popular method when he was involuntarily retired from the business through his arrest and conviction.

> Senator Gurney. What would you say is the principal means of disposing of stolen securities today?
> Mr. Wuensche. Today I would say that the majority of them, unless there is a favorable situation relating to an insurance company or a bank in this country, I would say that the majority of them are being utilized outside this country.
> Senator Gurney. They go to Switzerland or some other place?
> Mr. Wuensche. Switzerland, the Bahamas, other small islands that have small banks that can put them into a trust account, and then issue letters of credit against these trust accounts (Hearings, 1971, Part 3, p. 867).

> ... Mr. Wuensche. It is easier to place--at least it was up until the last couple of years--it was easier to place stolen securities outside the country into trust accounts, banks, overseas funds, mutual funds, and other diversified entities for the simple reason that these people would have a strange way of operating.
> If the security that you brought to them was not on what is known as a hot sheet, then they would take it as quick as look at you, make a deal with you, pay you, and send you on your way.
> If it was on the hot sheet, they, on the other hand, would push the button. They would tell you to come back later. When you came back, Interpol would be waiting for you to take you away (Hearings, 1971, Part 3, p. 861).

> ... Mr. Wuensche. I have also been involved in various schemes which entailed the transfer of stolen securities to different sources in Europe who later transferred them to certain persons in foreign governments who, in turn, redeemed them for cash in the United States (Hearings, 1971, Part 3, p. 849).

Mr. White, the other expert witness who was convicted of federal crimes pertaining to stolen securities, also was involved in moving securities out of the country. In fact, his first conviction was for fraudently moving $80,000 to Zurich; he acknowledged that once he got the money to Zurich he put it in a numbered account.

Placing Stolen Securities in Insurance Company Portfolios

The fourth method of disposing of stolen securities is to place them in portfolios of insurance companies or any other entity which has a need to present a more favorable financial posture. As an example of organized crime's involvement in this activity, the Harry Riccobene case was previously cited. Mr. Riccobene was convicted of selling a stolen $500,000 U.S. Treasury bill to an Indianapolis, Indiana, insurance company for $150,000 cash and 87,000 shares of corporate stock. Testimony revealed that at the time this deal was consumated the insurance company was in a poor financial situation and used this Treasury bill to enhance the financial picture it presented to its directors and the public. Mr. White also gave examples of this method of disposition when asked.

> Mr. Adlerman. Can you tell us, to your knowledge how wide spread is the practice of using stolen or counterfeit securities as underlying collateral for payment guarantee bonds, insurance payment guarantee bonds?
>
> Mr. White. There are many instances of counterfeit and stolen and investment stock and dubious stock being utilized in insurance companies.
>
> State Farm in Miami was one such instance; Community National Life Insurance of Tulsa, Oklahoma, is another such instance (Hearings, 1971, Part 3, p. 697).

Summary

As outlined in the opening of this chapter, the purpose of it is to fuse together organized crime and the theft and subsequent disposition of securities. It can be surmised from the testimony given at the Hearings that the amount of securities being stolen is considerable. This amount may be even larger than has been reported. Documenting organized crime's involvement in these activities is most difficult, but if one can credit the testimony of many law enforcement officers, including the former Attorney General of the United States and the testimony of self-admitted organized crime operants, then it can be believed that organized crime was quite active in the theft and subsequent disposition of securities.

It has been determined that there are two separate criminal acts, the act of theft and the act of disposing of the stolen securities. Primarily the thefts have taken two forms: theft by securities industry employees and thefts from the U.S. mails.

The four methods of disposition have been described by example. Each one has required a considerable amount of expertise, and organized crime has found and used those individuals who possess this expertise.

With the theft and subsequent disposition of securities being established, it is necessary next to examine what

efforts have been taken to eliminate or reduce these criminal acts.

CHAPTER V

CONTROLLING THE THEFT AND SUBSEQUENT DISPOSITION OF SECURITIES

> Gambling is the single most important activity for organized crime. ... Loan-sharking is big business but it couldn't exist without the gambling as its base. Securities have been a big moneymaker, but maybe that will come to an end now.
>
> Vincent Teresa, self-admitted organized crime figure and convicted trafficer in stolen securities (Hearings, Part 3, 1971, p. 813).

Mr. Teresa believes that because of the attention given to the problems prevented by the theft and distribution of securities by the Permanent Subcommittee and because of the action taken by the securities industry, these will be eliminated or greatly reduced. As is to be expected with problems of this magnitude, suggestions and remedies for solving them abound. The purpose of this chapter is to examine the proposed remedies to determine, if indeed, these solutions provide viable answers to a very serious dilemma.

As discussed, there are two often independent criminal acts committed in the theft and disposition of stolen securities--first the theft, then the disposition. This naturally involves two separate victims; first is the one who had the securities stolen from him, and the second is the victim who buys or receives as collateral the stolen securities. As would be expected, the proposed remedies pertain to stopping or controlling one of the two criminal acts involved. The

proposed remedies usually call for either reducing the theft by increasing physical security measures utilized by broker-dealers, or the solutions pertain to the eliminating of the certificate or otherwise modifying the way the stock certificate is handled and processed. In each of these proposed remedies, there are two types of proposals being offered. The first type is designed for immediate implementation and is viewed as a short-term solution. The second type is for long range implementation and would require considerable changes to be made in the method of operation in the securities industry. It may also even require changes in state and federal statutes.

Each of these proposals will be discussed and analyzed. Initially the remedies which could be implemented immediately, with little business modification required, will be presented. Many of these proposals deal with the prevention of thefts, and especially they emphasize increasing the physical security and control provided by the brokers and dealers. In this area, both individual actions of one broker will be discussed as will be the collective actions of the industry. Two specific aspects of the industry's personnel operations will be analyzed; they are personnel selection and the fingerprinting of employees.

In addition to efforts which can be taken by the securities industry, there are actions which can be implemented by various law enforcement agencies. Presented first

will be a discussion of why the theft of securities should be made a federal crime. Then the need for coordinating and/or consolidating federal law enforcement efforts will be studied. Also to be discussed is the Contanerization-Convoy system of handling mail at airports by the U.S. Postal Service.

After the operations of the securities industry and various law enforcement agencies have been discussed, the efforts directed at curbing distribution of stolen securities will be considered. The importance of identifying stolen securities as such will be discussed. Then two systems of identifying stolen securities, the National Crime Information Center and the Securities Validation System, will be explained.

The use and the failings of internal and external audits will be mentioned. It may come as a surprise that the testimony concerning audits presented them in a rather unfavorable light.

The role of the federal regulatory agency, the Securities and Exchange Commission and what it can do to control securities thefts and disposition thereof will be detailed.

Finally, those recommendations which are of long range nature and require considerable modification of the business process will be examined. These include the immobolization and the elimination of the stock certificate.

Remedies for Immediate Implementation

The proposed remedies to be considered first are those that pertain to the reduction of thefts from brokers and dealers. Most of these are of a short range nature in that they can be introduced immediately and would not drastically alter the method by which the securities industry conducts its business.

Physical Security

Many of the witnesses who testified before the Permanent Subcommittee, to include law enforcement, securities and criminal personnel, commented upon how ineffective or nonexistent the physical security provided by the brokers and dealers was. Consequently, the most pressing recommendation made by these witnesses was that the individual brokers and dealers take the steps required to strengthen their physical security practices. Few would fault this recommendation, and at this time many of the major securities firms have already implemented this proposal.

Individual Attempts to Increase Physical Security

The brokerage firm of Merrill Lynch, Pierce, Fenner, and Smith, Inc., is the largest firm in the country and is publicly owned. The chairman of its board informed the Permanent Subcommittee that as of January 1, 1971, it had suffered at least three major thefts with losses totaling $2.4 million. But during the first six months of 1971, it

did not experience any major thefts. Mr. Regan, the chairman, attributed this primarily to the increased efforts the firm had placed upon physical security and other protective measures.

In 1969 Merrill Lynch established a separate department devoted entirely to security. This department is headed by a former FBI agent, includes on its staff seven investigators, including three former FBI agents, two New York City Detectives who had been assigned to that department's special Stock and Bond Squad, and two investigators with private industrial security experience. One of these investigators is an accountant who specialized in embezzlement cases. In addition to the investagatory staff, this department has a security guard staff.

The Protection Services Department provides six general services. They are: (1) a fingerprint program in which all new employees are fingerprinted, and whether or not they have a criminal record is verified through a fingerprint check; (2) investigations of losses of securities, cash, checks and physical property both in the home office and branches; (3) security surveys to determine where and how security practices can be improved; (4) liason with public law enforcement agencies; (5) authenticity checks of questionable securities where branch offices can call and verify whether a stock certificate being presented is legitimate; and (6) the providing of training programs to educate all

employees on the problems of stolen securities. Mr. Regan and the head of the Department of Protection Services testified that they feel that the program has been quite beneficial and worth the expense. Other witnesses, not employed by Merrill Lynch, also testified that the increased security services provided by Merrill Lynch were what were needed, and these also served as a model to be followed by other brokerage firms.

Merrill Lynch's protection services program, however, is not without a liability. The liability in this case is the expense. Mr. Regan testified that in 1970, Merrill Lynch spent $1,000,000 on its security program, and this was up from $250,000 spent on security in 1969. It should be noted that this type of expense is born by the brokerage firm, reducing the firm's profits, and is not absorbed by the customer. The type of physical security and related programs provided by Merrill Lynch may be ideal, but quite possibly smaller brokerage firms with smaller profit margins may not be able to afford such a program; expense is a very relevant consideration. In personal correspondence with the author of this study[4], the manager of Merrill Lynch's Protection Services Department advised that although all brokerage firms and banks have attempted to tighten their physical security practices, only a small number of firms currently have a separate department with specially trained personnel to handle these problems.

Collective Attempts to Increase Physical Security

An alternative to individual brokers and dealers having their own security departments is for the firms to join together and provide a collective service which can be tapped as a resource when needed by the firms which cannot afford their own departments.

Both of the major exchanges, the New York Stock Exchange and the American Stock Exchange, have, during the past five years, formed special subcommittees to provide guidance to member firms in the area of physical security. Representatives of these special subcommittees have made studies to evaluate the effectiveness of the security precautions taken by the member firms, and each exchange has the power to fine member firms for unwise practices which indicate poor physical security. Each firm has levied such fines, especially the New York Stock Exchange, as noted previously.

Perhaps two of the most effective collective programs for the tightening of physical security and related measures are industry wide special committees which were established during the period of crisis. In late 1968, several representatives from the securities and banking communities met with New York County District Attorney Frank Hogan and reviewed the latest intelligence related to organized crime and the securities industry. After this meeting, three men that had attended it, a vice-president of the New York Stock Exchange, a partner of a major brokerage firm and a

representative from a major bank, met for further discussions. These three became convinced that the industry needed to ban together and take the offensive in combatting securities thefts. This would be counter to what the industry had been doing previously--that is, being on the defensive and only reacting to thefts. Out of these meetings the Joint Bank-Securities Industry Committee on Securities Protection was formed. Since it was formed, this Committee has been quite active in combatting thefts and other crimes in the securities industry.

The Committee asked for and received both staff and financial support from the two major stock exchanges, the National Association of Securities Dealers and the Association of Stock Exchange Firms. A special subcommittee of this Joint Committee was formed to study methods of physical security and provide this information to all those who wanted it. According to the testimony given to the Permanent Subcommittee, this organization has been most diligent and successful in abating further securities thefts. Collectively, goals have been achieved which individual brokers and dealers may not have been able to accomplish individually.

The Joint Committee's most noted successful action was a lobbying effort which initiated and aided the passage of a law by the New York State Legislature which requires that the majority of the securities industry employees employed in the State of New York be fingerprinted and be checked for criminal

records. This Joint Committee attempted to duplicate this effort by having a federal law requiring that securities employees nationwide be fingerprinted, but they were not successful in this effort.

A second organization which has put forth considerable effort in attempting to assist brokers and dealers in the tightening of security is an organization which also participated in the formation of the Joint Committee described above; this is the Association of Stock Exchange Firms, which is now known as the Securities Industry Association. In 1970 the Association of Stock Exchange Firms, in association with the William J. Burns International Detective Agency, began to prepare an Internal Security Handbook. The book was finished and released in 1971; its stated purpose is to provide a guide for securities firms on how to formalize and improve their internal security program. The volume contains ten chapters and provides step-by-step detailed instructions for any sized brokerage firm to follow. A review of the manual indicates that there are numerous actions a brokerage firm can take at no or minimal expense to improve their internal physical security.

It would appear that these initial cooperative actions have been both useful and successful and should be continued in order that brokerage firms of all sizes can increase their internal physical security without unreasonable financial drain.

Personnel Selection

Two of the practices, which many of the witnesses appearing before the Permanent Subcommittee and both of the special joint committees on security practices emphasized, are of enough significance to warrant special discussion herein. The first pertains to the selection process for new personnel. It should be remembered from Chapter II that during the high volume period, the securities industry did considerable hiring; 25,000 new employees alone in 1968. It has been demonstrated that during this period of accelerated hiring, personnel selection was casual and obtaining a sufficient number of employees was a much more important consideration than obtaining reliable employees. Among those hired were a considerable number of unreliable and untrustworthy people, some of whom, according to evidence presented to the Permanent Subcommittee, turned out to be either "connected" with organized crime or at least vulnerable and susceptable to pressure from it. All of those who offered recommendations on the personnel practices of the securities industry emphasized that hence forth the industry will have to exercise more care in employee selection, especially when filling relatively low paying clerical positions.

Fingerprinting

One way some control can be exercised over who is hired by a brokerage firm is through background checks and fingerprinting. As noted, New York State now has a law

requiring that the majority of those employed in the securities industry within the state be fingerprinted. This law appears to be a partial answer to acquiring background information on employees. Several other states, California in particular, are currently considering similar legislation.

Such action, however, is not without difficulty and is not a cure-all. The New York Fingerprint Law became effective in September, 1969, and was immediately challenged in the courts by some securities industry employees as an invasion of privacy. The New York Chapter of the American Civil Liberties Union assisted in the legal challenge (The Wall Street Journal, September 22, 1969). On November 20, 1969, Judge Weinfield of the U.S. Court of Appeals for the Second Circuit ruled against those bringing the suit and stated that the fingerprinting of employees was not an invasion of privacy (The Wall Street Journal, November 21, 1969). The matter was appealed to the U.S. Supreme Court. On May 18, 1970, the U.S. Supreme Court denied certiorari (Miller vs. The New York Stock Exchange, et. al., 905 Ct., 1690, 1970).

With respect to the fingerprinting of securities industry employees, another problem still exists. This involves getting access to official records of fingerprints and criminal records. According to witnesses before the Permanent Subcommittee and according to experts in the field of criminal justice, the Federal Bureau of Investigation has the most extensive and complete records of fingerprints of any law

enforcement agency in the country. It is the policy of the FBI to share these records only with other accredited public law enforcement agencies, and it will not furnish fingerprint checks to private business firms or private investagatory agencies. This FBI policy has been supported by the decision reached in Menard vs. Mitchell, 430 F. 2d, 486 (1970).

Prior to the time of the public hearings on organized crime and stolen securities, representatives of the securities industry had unsuccessfully attempted to arrange a method, either by direct contact with the Federal Bureau of Investigation or through the New York City Police Department, to check the fingerprints of its employees. These efforts were unsuccessful. However, the industry did arrange to have all fingerprints checked through the office of the Attorney General of the State of New York. According to the Manager of Protection Services of Merrill Lynch, this method of checking is still being used, and the checks have been expedited.

From the problems the securities brokers and dealers in New York State experienced, it would appear that the states that expect to enact similar legislation need to plan in advance how the fingerprints will be checked.

Another question that needs to be answered with respect to the fingerprinting of employees is just how effective a tool it is. New York State Attorney General Louis J. Lefkowitz (The Wall Street Journal, February 5, 1970) announced that a massive check of the fingerprints of

approximately 20,000 New York State brokerage firm employees, made between the time of enactment of the act, September, 1969, and February, 1970, revealed that 341 of these employees had criminal records.

Mr. Lefkowitz also disclosed that this check of fingerprints resulted in twenty-nine low level employees being dismissed and another twenty-four employees resigning before the returns from the fingerprint check had come in. It was also noted that about half of the employees dismissed had been arrested but not convicted.

After this announcement by the State's Attorney General, representatives of the New York Stock Exchange and the American Stock Exchange issued a joint statement noting that only about 2 percent of the first group of securities employees had had criminal records, while the reported national average of employees to be discovered with criminal records through fingerprint checks in other industries was 4 percent (The Wall Street Journal, February 5, 1970).

Clearly the number of those initially ascertained through fingerprint checks to have criminal records was small, but it is felt that any reduction of risk by eliminating questionable personnel would appear to be worthwhile and recommended as a future practice.

Recommendations for Law Enforcement Agencies

Assumingly it is clear from the above that the securities industry itself needs to take additional security precautions in order to reduce the loss from securities thefts. But they alone cannot do the job. Additional steps need to be taken by law enforcement agencies, in cooperation with the securities industry. With respect to the law enforcement efforts, there are several obvious recommendations that seem to be of considerable merit.

Making Securities Thefts a Federal Crime

From a reading of the testimony given before the Permanent Subcommittee, one can surmise that the Senators and their staff were somewhat surprised when it was definitely ascertained, from the then Attorney General John Mitchell, that the actual theft of the stock certificates of private firms is not a federal crime unless transferred across state lines. Neither is the possession of stolen U.S. Treasury bonds a federal crime.

Most witnesses recommended that such acts be made federal crimes, and especially vehement were the representatives of the securities industry. Mr. Haack, President of the New York Stock Exchange, presented a draft of a legislative proposal which would ammend Section 2113 of Title 18 of the United States Code by adding broker-dealers to the section which presently applies to thefts from banks and

savings and loan associations (Hearings, 1971, Part 2, p. 354). The broker-dealers to which this amendment would apply are all those who are members of the Securities Investor Protector Corporation, a government-industry agency that is designed to come to the aid of customers of brokerage houses that go bankrupt.

If such a proposal was enacted, the stealing of stock certificates, bonds, notes, etc., from federally insured brokers and dealers would be a federal crime, as are thefts from federally insured banks and savings and loan institutions.

The reasons for such a proposal should be obvious; it has been illustrated that the theft, and especially the disposition of stolen securities, is not a local crime. This crime is one in which the solving thereof is quite often beyond the jurisdiction, if not the capabilities, of local law enforcement agencies. Witnesses informed the Permanent Subcommittee that the police department of the City of New York is the only local law enforcement agency with a specialized unit, known as the Stock and Bond Squad, whose function is to handle securities thefts. The reason that the New York City Police Department has such a specialized unit is apparent; New York City is the financial capital of the country and the site of more securities thefts than anywhere else.

However, even the capabilities of the N.Y.P.D. Stock and Bond unit are limited by jurisdictional boundries. The

testimony revealed that quite often the fruits of the thefts which the N.Y.P.D. Stock and Bond Squad were investigating were disposed of all over the world, and thus the crime then came to the attention of federal and international law enforcement agencies. It is felt by some experts, and this position is well supported, that if the crime was the jurisdiction of federal authorities from the time it was known, apprehension might be facilitated. At least nationwide efforts could be better coordinated.

It should be noted that the Hearings which are being used as the prime resource documents for this study were held in 1971, and it was at that time that the recommendations, including the one that the theft of securities be made a federal crime, were made. A staff member of the Permanent Subcommittee[5] advised that as of June 1, 1973, the Permanent Subcommittee on Investigations had not issued its final report or organized crime and stolen securities. Neither have any members of the Permanent Subcommittee submitted legislative proposals that would make into law some of the recommendations that were submitted to the Permanent Subcommittee. Therefore at this time the theft of securities is still not a federal crime. It is believed that such an act should be made a federal crime as soon as possible.

Coordinating/Consolidating Federal Law Enforcement Efforts

As mentioned above, the main argument for making the theft of securities a federal crime is to provide for

coordinated nationwide efforts of apprehension. In order to evaluate that recommendation, a look should be taken at current federal law enforcement efforts. This is not as encouraging as one would hope.

One of the key problems appears to be that there are numerous federal law enforcement agencies with specialized jurisdictions. If the securities are transported across state lines, jurisdiction belongs to the Federal Bureau of Investigation. If the securities are stolen from the mails, jurisdiction belongs to the U.S. Postal Service. If, however, the securities are stolen at airports, jurisdiction may go to the U.S. Customs Bureau or the newly established airport protection agencies either under federal (Department of Transportation) or local jurisdiction. If the securities are counterfeit rather than stolen or are Treasury notes and bonds, jurisdiction belongs to the U.S. Treasury Department; the SEC is also involved.

Obviously, there is a plethora of jurisdictions and overlapping, and several securities industry representatives stated that, in addition to the need for the theft of securities to be a federal crime, it would also be desirable if there was a single federal law enforcement agency which had jurisdiction in these matters.

To some degree, this has been accomplished for certain types of federal criminal investigations, especially those pertaining to organized crime; this has been done through

the establishment of the so-called Organized Crime Strike Forces. These Strike Forces are located in major metropolitan areas of the United States, places where organized crime centers are believed to be located, and are under the jurisdiction of the U.S. Department of Justice and their local representatives, the U.S. Attorneys. These Strike Forces are manned by representatives of the various federal law enforcement agencies such as the FBI, the various Treasury Department investagory agencies, the drug enforcement agencies, the Post Office Service, etc. It is contended that these Strike Forces centralize and coordinate federal law enforcement efforts, and are, thus, better able to combat the efforts of organized crime. It was through the efforts of the Philadelphia Organized Crime Strike Force that Harry Riccobene (as mentioned earlier) was arrested and convicted. It would appear that such centralizing and coordinating efforts on the part of federal law enforcement agencies are to be applauded and continued. With respect to securities thefts, some central federal law enforcement agency seems to be advisable, if not mandatory.

Recommendations for Further Study

At this juncture in the discussion it is deemed appropriate to offer both a recommendation for further study and a recommendation for the consideration of additional federal legislation. Each of these recommendations are a result of the information garnered through this study.

The first is a recommendation that further study be made of federal law enforcement agencies. It is probable that each federal law enforcement agency knows its purpose, jurisdiction and function. Yet it is quite doubtful that the public is clear as to which federal law enforcement or investagatory agency is responsible for which specific federal law or federal crime. A number of security industry witnesses told the Permanent Subcommittee that when a crime was committed, they were quite unsure of who to contact and were often referred to several federal agencies before contact with the appropriate one was made.

The study being recommended would identify each federal agency with law enforcement or investagatory responsibility. It would then analyze and itemize each agency's enabling legislation, purpose, function and jurisdiction. The study could then identify where there is overlap and lack of coordination and perhaps offer recommendations to reduce the duplication of services and functions.

The second recommendation is perhaps a bit premature and is anticipatory of the above study. But it is recommended that a single, wholly independent Federal Criminal Investagative Agency be created. This agency would supplant many of the existing agencies and provide for coordination of federal law enforcement and investagatory functions. In conjunction with this recommendation and the above proposed study, it would be realized that historically the people of the United

States have feared the creation of a central police force, and this fear should be analyzed in the suggested study. But quite possibly, the overabundance and duplication of federal law enforcement agencies may present as many serious problems as one single agency. The study proposed above should reveal the need for or justification of the proposed single federal criminal investigative agency.

At the present time, there is growing support for such a single federal investigative agency. In a speech made on June 3, 1973, to the graduating class of the John Jay College of Criminal Justice of the City University of New York, the recently resigned United States Attorney for the Southern District of New York, Whitney North Seymour, proposed divorcing the Federal Bureau of Investigation from the U.S. Department of Justice and creating a central federal investigatory agency. In their issue of June 4, 1973, the New York Times reported:

> 'The one sure remedy,' he said, 'is to split the agency.' He suggested that 'part of the FBI be spun off and merged with other Federal investigative agencies to be a wholly independent Federal Criminal Investigative Agency.'
>
> Such an agency, he contended, would 'help solve many of the troublesome reorganization problems in Federal law enforcement in such fields as narcotics, and organized crime, which have caused so much disruption and dissension (New York Times, June 4, 1973, p. 31).'

Mr. Seymour also pointed out that in most governmental divisions, the prosecution function and the investagory function are not located in the same agency as they are in the

federal government, with the FBI being a part of the U.S. Department of Justice. He concluded that a separation of these two functions would be wise.

Combatting Mail Thefts

Before finishing with the law enforcement aspect of reducing securities thefts, mention must be made of the Containerization-Convoy system (Con-Con) of transporting mail from air terminals to airplanes. This program was instituted by the U.S. Postal Service after a considerable number of mail thefts were realized. It was begun first at the John F. Kennedy International Airport, in New York in 1970, and after proving successful, its use was expanded to other major airports in the New York metropolitan area and finally to selected major airports across the country. The Chief Postal Inspector declined to name in public hearings the airports at which Con-Con was used (Hearings, 1971, Part 1, p. 124).

With Con-Con, registered mail is separated at the air terminal from regular mail shipments and is placed in containers and transported in convoy under guard from the airport terminal to the airplane. The mail does not become the responsibility of the airlines until it is placed on the plane.

When asked how successful the Con-Con system was, the Chief Postal Inspector was quite enthusiastic and supported his position with facts and figures.

Chairman McClellan. With the actions you have already taken, are you seeing good results?

Mr. Cotter. I think they are miraculous, Mr. Chairman. Since November of last year our losses for all intents and purposes--from 1967 to 1970, we lost over $70 million--our losses have been about zero. There are a couple of pouches that were lost subsequent to this period. I am not too sure they were in the convoy system and I am not positive they are lost. But for all intents and purposes, the losses are down to zero (Hearings, 1971, Part 1, p. 124).

Mr. Cotter's testimony is refuted, or at least damaged, by that of a professional thief when asked by Senator Gurney whether he had had any direct experience with the Con-Con system.

Mr. Cudak. I would say that the convoy system is probably an answer to the thefts. But if you ask me did I ever beat it, yes, I did.

Senator Gurney. How did you do this?

Mr. Cudak. There was only one occasion. I was bringing mail down from the post office. In other words I was scheduled to bring the mail from the post office to my flight. So they sent an armed guard from the post office to the Northwest flight. The practice they have is I think they are supposed to hold the mail in their hand until like 3 or 4 minutes before the flight goes out.

So I was familiar with this. I had never tried it before but once I just wanted to try it. So the armed guard loaded the mailbag in the belly. What I did was I crawled into the belly, emptied somebody's clothes out of the suitcase and put the mailbag in the suitcase. I used to carry tickets with me like transfer tickets. These are luggage tickets for wherever the destination is. I put the mailbag in the suitcase and just wrote on the baggage ticket. I forget what town I used, but some town that we don't go to on Northwest Airlines.

Just before the plane was ready to go I just threw the bag on the ground and told one of the other guys to bring the bag over to the transfer point for the baggages. He just picked it up and took it over, and as soon as the plane went out I drove my truck over and picked up the bag and threw it in my locker. That was the only time (Hearings, 1971, Part 1, pp. 222-223).

In addition to not being foolproof and utilized at every airport, the Con-Con system has another liability. It

is quite expensive to use and involves considerable manpower. Mr. Cotter estimated that the cost of the convoy system, as it was being operated in 1971, was approximately $1,800,000 annually. And at the time of the Hearings in 1971, although the program required the consent of the airlines, the expense was borne totally by the U.S. Postal Service. It should be noted that at the time this expense was being borne by the U.S. Postal Service, an independent government cooperation was under heavy fire for not being self-supporting and operating inefficiently.

It would appear that no recommendation or solution is without shortcomings. However, as the containerization-convoy method of mail transportation does appear to have caused a significant reduction in mail thefts, its continued and expanded use is recommended.

Recommendations for Curbing Distribution of Stolen Securities

In the preceding, a number of steps relating to the tightening of security measures taken by those in the securities industry and those in law enforcement have been outlined and analyzed. It is believed that if these measures were adopted, they would be at least partially effective in reducing securities thefts. It should be remembered from the first three chapters, however, that the theft of securities has historically been accomplished with ease, and the high

volume back office crunch period of the late sixties made it even easier to steal securities. Yet it was the emergence of another factor that caused the tremendous increase in securities thefts. This, it will be recalled, was the increase in the sophistication and business accumen of those disposing of stolen securities and the corresponding increase in the ways and means of selling, borrowing and otherwise "using" stolen securities. Until these avenues of disposition of stolen securities are sufficiently blocked, the theft and disposition of securities will continue to be big business. A convicted trafficer in stolen securities agrees:

> Mr. White. That is a very difficult problem to stop the theft, because all of these people, as you say, are human, and very vulnerable. I don't think the theft is the cardinal factor. I think the cardinal factor is organized crime and the ability to dispose of these securities.
>
> There is no purpose in stealing anything that has no value or cannot be disposed of, you see. So why put the onus and the weight on the clerk working in the brokerage firm of the bank? Rather, the onus must fall upon the people who distribute and the people who accept it and the people who control it and provide the marketing facilities and the market for these things.
>
> I don't think anybody would steal anything that they can't do anything with. It is just not rational to assume that (Hearings, 1971, Part 3, p. 741).

Again, as in the consideration of controlling and reducing thefts, there are, in the consideration of controlling and making more difficult the disposition of stolen securities, both short and long term solutions and recommendations.

Identifying Stolen Securities as Such

The short term will be considered first. One of the prime recommendations is that means of quickly reporting and

identifying stolen securities be established. This should make the reselling of stolen certificates more difficult.

There are several aspects of this recommendation. One is that brokers and dealers must be made to, or at the least strongly encouraged to, report all losses and thefts of securities. This recommendation has been partially accomplished through the efforts of two types of organizations. The major stock exchanges have either passed rules or made strong pronouncements encouraging or requiring their members to report all thefts immediately. The major insurers have threatened brokerage firms, that either delayed in reporting thefts or refused to report thefts, with the loss of their insurance. Prior to the time of the Hearings, there had been considerable reluctance, primarily because of the adverse publicity, to report securities thefts. But currently, through these efforts of the exchanges and the insurers, and after such large concerns as Merrill Lynch and Morgan Guaranty Trust Bank reported promptly and forthrightly major thefts, prompt reporting by other firms has increased. For obvious reasons this trend should be continued, and if possible, the major exchanges and insurers should require their members or customers to report all losses promptly or face adverse action.

The other aspect of this avenue of disposition is the prompt identification of stolen securities which are presented for sale or as collateral. There was considerable evidence presented to the Permanent Subcommittee that during the crisis

period of stolen securities, a major factor in making the disposition of stolen certificates rather easy was the willingness of brokers and bankers to assume, without verification, that certificates issued in the name of major corporations such as IBM were legitimate and the property of the presentors. Quite often this was not the case.

The National Crime Information Center. There are at least two methods of gathering, maintaining and disseminating data on stolen certificates. The first method is through the National Crime Information Center (NCIC) operated by the Federal Bureau of Investigation. The NCIC provides state and city police forces with immediate access to computerized files on stolen property and wanted persons (Miller, 1971). Stolen securities are now part of the input of stolen property submitted to NCIC by law enforcement agencies.

The NCIC became operational in January, 1967, and since that time has been expanded so that this service is utilized by the majority of the major state and local law enforcement agencies in the country. However, the NCIC, as all new computerized systems, seems to have experienced numerous operational problems. There were also problems of communication and cooperation between agencies. The testimony of the Chief U.S. Postal Inspector will illustrate the problems existing between the NCIC and a major federal law enforcement agency.

Mr. Cotter stated that the Postal Service joined NCIC in 1968, but he emphasized that the system had not worked as effectively for them as they had hoped. The main problems for the Postal Service were in New York. At that time, all postal information was submitted by the Postal Service through the NCIC terminals operated by local police departments. One reason for the difficulties with the New York Police Department was that the local department had considerable amount of information to feed into the NCIC system.

Mr. Cotter admitted that although some of the identifiable stolen goods from the Kennedy Airport were reported to NCIC, much of it was not. At the time of the Hearings, Mr. Cotter stated that the Postal Service planned to get direct interface with NCIC by January, 1972. It can be surmised, however, that the Postal Service was at that time getting only limited use of the NCIC service, and the evidence presented at the Hearings shows that only a part of the securities stolen from airports had not been reported to the NCIC. Several of the Senators on the Permanent Subcommittee were astonished and perplexed that one federal agency was using another federal agency by way of a local police agency.

It should be realized that the above experience was not a unique one. The Assistant Secretary of the Treasury, Enforcement and Operations, when questioned by members of the Permanent Subcommittee, was unable to detail specifically the Treasury's methods of reporting thefts of government bonds

and other securities to the NCIC. After this exchange Mr. Rossides, the Assistant Secretary, agreed to supply the Permanent Subcommittee with this information at a later date. The later statement says in part:

> Mr. Rossides. In responding to this inquiry, we would suggest that the NCIC is the focal point for listing reports of stolen United States savings bonds and savings notes. Thefts of these securities are reported to NCIC by the Secret Service. Thefts of other Treasury securities are entered into the NCIC by the FBI and local law enforcement authorities. Arrangements are underway in the Department of the Treasury to develop direct and complete entry into the NCIC, through the Secret Service as Treasury's representative, of all reports received by the Department of lost or stolen marketable Treasury securities and Government agency securities (Hearings, 1971, Part 1, p. 163).

The primary purpose of the NCIC is to serve as an investigative aid for law enforcement agencies in the identification of stolen securities and the apprehension of suspected thieves. It is clear from the above testimony that as of June, 1971, after more than three years of operation, when two major federal law enforcement agencies did not have direct, total access of input and output to the NCIC, its function and purpose had not been fulfilled. Thus, the NCIC is not as useful as it should and could be.

It should be noted that even though access was not complete and total for law enforcement agencies, only law enforcement agencies had access to the NCIC. So, if a broker or dealer wished either to insert identifying information on stolen securities, or more likely, to check whether securities being presented to it for resale were legitimate, the broker

had to make the check through a law enforcement agency with direct access to the NCIC. Most of the checking done by brokerage firms would be done through their New York City offices. With the U.S. Postal Service's experience with utilizing the NCIC terminal of the New York Police Department, it can readily be seen that access for the broker-dealers is severely restricted and would in all probability be quite time consuming. Therefore, the NCIC is a very useful idea and has proved, despite initial shortcomings and operational difficulties, to be of great usefulness in many instances. However, the NCIC does not appear to meet all of the stolen securities informational needs of the securities industry. Supplemental means must be devised and utilized.

The Securities Validation Corporation. In 1969 the Joint Bank-Securities Industry Committee on Securities Protection, mentioned previously, recognized that the NCIC system was useful but would not fulfill completely the needs of the financial community, primarily because of the limited accessibility. Efforts were then taken to have a commercial organization establish a simple, economical real-time system which would be accessible via a tele-typewriter terminal and would have a secure base (duPont, 1972). The result of these efforts is known as the Securities Validation Corporation. Both the systems are known and referred to as Sci-Tek. Sci-Tek provides to legitimate members of the securities industry a service for the verification of securities' ownership

similar to that provided law enforcement agencies by the NCIC. The chairman of the board of Sci-Tek, in an article he wrote, describes how the system works.

> Each subscriber maintains his own lost and missing file in the data base by transmitting, via his terminal or convential telephone, update transactions (addition; securities lost on the premises or lost in the mail), and delete transactions (removal; security recovered, not replaced). Each subscriber checks any securities from his customer for sale or for collateral by transmitting an inquiry transaction (data base is searched to match the security type and identification number). On a 'hit,' a confirm transaction is transmitted to get the name of the inputting subscriber, the responsible person to be contacted and his phone number (duPont, 1972).

In the article, Mr. duPont (1972) cites a number of successful recoveries made through the use of the Sci-Tex system. On June 18, 1971, a midwest bank was approached by an unknown individual to obtain a collateral loan, ledging $125,000 of stolen common stock certificates. A subscribing member firm verified that the items had been reported stolen, and the loan was not made. In December, 1971, six $1,000 bearer bonds were recovered by two subscribing brokerage firms. The speed of confirmation led to the apprehension of one individual while at the office of the member brokerage firm. In July, 1972, sixty-six confirmations (positive identification of stolen securities) were made by a subscribing bank which had just recently joined the system. The total value of the recovery was estimated at $180,000; the items had been reported lost by two brokerage firms. Mr. duPont was particularly proud of this recovery because the firm had

encountered much reluctance on the part of banks to participate in Sci-Tek. This somewhat negative attitude towards the usefulness of Sci-Tek for banks was illustrated in testimony given to the Permanent Subcommittee by the Executive Vice-President of Morgan Guaranty Trust Company of New York.

> Senator Ribicoff. Would you want to comment on the usefulness of the Sci-Tek securities validation system from a banker's point of view?
>
> Mr. Rohlf. This was brought up in New York City. I am a member of the Joint Industry Group that represents both industries. That has been in operation now for several years. Their situation is entirely different than that of a bank. We in the banking business, for example, take in very few securities from unknown people.
>
> On the other hand, the brokers are dealers in securities and buy and sell them where to take them in as loans. We feel that through knowing the customer and giving the NCIC a chance is the better approach. It is just a difference of opinion (Hearings, 1971, Part 2, p. 500).

As illustrated in Chapter III of this study, the "know the customer" rule is not a guarantee that the customer will not attempt to use stolen securities as collateral. It would appear to be equally important, if not more so, to know the security and whether it is authentic and legally held.

The cost of membership for a firm subscribing to Sci-Tek is $3 per month ($36 per year) and ten cents per inquiry made into the system. In his appearance before the Permanent Subcommittee, Donald Regan, chairman of the Board of Merrill Lynch, enthusiastically endorsed the Sci-Tek system. He advised that his firm had participated in the pilot project and was a subscriber to and a believer in the benefits of the privately operated securities validation system.

Both Mr. Regan and Mr. duPont pinpointed the one fatal flaw in Sci-Tek's Securities Validation System. At the time of the Hearings and currently, subscription to Sci-Tek is voluntary. At the time of the Hearings, Mr. duPont stated that of the approximate 700 major brokers in New York City, only seventy were subscribers to the Sci-Tek system.

In their discussions with the Permanent Subcommittee, both Mr. duPont and Mr. Regan emphasized that if the securities validation system is to be effective, it must have more subscribers. The ideal would be for all securities brokers and dealers and major banks to participate. Mr. duPont stated that he believed that the governoring boards of the major stock exchanges had the power to require their members to provide some type of securities validation system, and he hoped that in the near future the governoring boards would exercise that power.

Sci-Tek did not reply to an inquiry made for this study, but Mr. Caswell[4], Manager of Protection Services for Merrill Lynch (1973), advised that more firms and a few banks had joined Sci-Tek since 1971. However, participation was still optional, and Sci-Tek's biggest liability was that it could not supply total verification services because it was not receiving total input of all securities lost or stolen. Mr. Caswell was still hopeful that fuller participation would be achieved in the near future.

It can be seen that this service does provide the accessability that the NCIC does not now, and may never, supply to private firms, but like NCIC, Sci-Tek does not have all the information on file that it should have. The Sci-Tek Securities Validation System would be remarkably more effective if this lack of full participation by the securities and banking industries were corrected as soon as possible.

Identifying Stock Certificates in the Transfer Process

Another recommendation, and one which was offered by one witness appearing before the Permanent Subcommittee and then picked up and advocated by at least one Senator, is the stamping of "for transfer agent only" on securities enroute to the transfer agent. This practice would be similar to stamping "for deposit only" on the back of endorsed checks which are enroute to be deposited in a bank. According to the testimony given by an expert witness, a convicted stolen securities trafficer, the stamping of securities "for transfer agent only" would only be a minor step in the tightening of the means of disposing of securities.

> Senator Gurney. A couple of simple questions here: What if you immediately stamped on a certificate 'For Transfer Agent Only' when it is brought into a brokerage firm to be sold?
>
> Wouldn't that limit the theft of those securities at least?
>
> Mr. White. It would limit the theft of those securities but those securities must go to transfer and the transferred securities must come back and they must go through the mail. They are available. They are there. The only thing that you do is preclude the one possibility of that particular theft (Hearings, 1971, Part 3, p. 741).

The Effectiveness of Audits

For many years in the securities industry, it was held that losses and thefts, if they occurred, would be discovered quickly because of the extensive policies and practices concerning both internal and external audits. Another lesson learned during the period of the dual crisses of the paper work overload and heavy thefts of securities was that the audits were not as effective as believed. This was made particularly clear in a letter of resignation and condemnation from the former chairman of what was known as the New York Stock Exchange's Crisses Committee; this committee operated during the peak periods of the paper work overload and attempted to monotor the back office and financial capitalization operations and problems of the NYSE member firms. The letter was addressed to the chairman of the board and the president of the New York Stock Exchange. It says in part:

> The questions raised by the not infrequent inaccuracy of both internal and audited reports will have to be studied by the Exchange. In my opinion, they involve the entire concept of self-regualtion since, if our tools are inadequate, we either have to get new tools or someone else should do the job.
>
> I think we have, at enormous cost and with little public recognition, paid for the sins of the past and have stopped the current bleeding. I am not convinced that we have adequate early warning and adequate measuring to prevent reoccurrence if industry conditions should change again. ...
>
> I believe that capital rules that are not only stricter but less subject to interpretation, together with the new rules with respect to box counts and the aforementioned mandatory change of auditors every three years could provide the Exchange with a safer member firm structure and surveillance tools that should be more effective (Hearings, 1971, Part 2, p. 373).

Mr. Roythan did not appear before the Subcommittee, but a number of people, who talked with him about the audits and other problems facing Wall Street, testified that Mr. Roythan had indicated to them that he had felt quite strongly about the inadequacy of brokerage firm audits, and this was one of the factors that prompted his resignation. His feelings appear to be justified. Audits were somewhat successful in determining the financial position of various brokerage firms, but they were of little use in determining the number of missing, stolen or lost securities. When checking the securities held by a firm, both internal and outside, independent auditors count the number of securities contained in a box but do not check the certificate's number to verify authenticity or ownership. The president of the New York Stock Exchange confirmed this for a staff member of the Permanent Subcommittee.

> Mr. Haack. It is a sample count.
> Mr. Adlerman. They don't actually check the securities to see whether or not the securities that are supposed to be there are really in the boxes or the stacks, nor do they check the numbers to see whether or not the securities are good securities or stolen securities.
> Mr. Haack. You are correct (Hearings, 1971, Part 2, p. 350).

Based upon the evidence presented to the Permanent Subcommittee on the number of stolen securities unaccounted for, over $400 million worth which was stolen during 1969 and 1970, it would appear advisable for the audits, if possible, to be of a more specific nature so that the authenticity and

ownership are verified. Both the president of the New York Stock Exchange and the chairman of the board of Merrill Lynch stated that they were in agreement with Mr. Roythan's statements, and they testified that efforts are currently underway to strengthen and tighten auditing practices and requirements. This action appears warranted and should be continued.

An interesting question to be answered is what would these more intensive and accurate audits disclose. As noted earlier, many of the stock certificates are held by institutional investors. They are held for prolonged periods of time, and apparently the only periodic check of these certificates is a physical count. It is quite possible that a careful audit, one which would verify the stock certificate as bona-fide and not stolen, would reveal that there has been so much theft and substitution of certificates that many institutional investors, and even large single investors, do not own or have in their possession all the stock certificates that they believe they do.

If the supposition is ture, it could mean that the securities market, and thus the economy of the country, has been grossly inflated through the buying and selling of stolen and counterfeit securities. If this is true, then one can assume that the economy is in even worse condition than the economists and elected officials have been telling the public. The answer to these questions and suppositions may not be

known for some time, but if they do become known and are as hypothesized, the economy would surely suffer considerably. It could even quite possibly be worse than the historic period of October, 1929.

The Role of the Securities and Exchange Commission

Robbins, et. al. (1969), pointed out that it has been the custom of the SEC to rely on the measures adopted by the self-regulating bodies. However, in recent years, because of several factors (the increasing volume in the industry, the paper work overload, the huge losses via thefts), the SEC has taken a more active role in regulating the industry, which it is required by law to oversee. Several observers noted that the SEC is only one of several governmental regulatory agencies to become more sensitive and active during this period of consumer action and consumer (investor) protection.

With respect to the theft and disposition of stolen securities, the then chairman of the SEC explained the reasons behind the Commission's action or inaction to the Permanent Subcommittee:

> Mr. Casey. We administer some half dozen statues in the general field of securities and finance. However, the detection, surveillance, infiltration, and apprehension of persons engaged in the theft of securities has been left to the Federal Bureau of Investigation and other law enforcement agencies having more specific authority in this area. ...
>
> Commission enforcement personnel and procedures quite frankly are not geared to do this kind of work. We do not have the funds to pay informers. We do not have the personnel or equipment to follow people or place under surveillance the places where criminals congregate. ...

> Accordingly, whenever the Commission's staff had obtained information concerning stolen securities it has referred such information to the appropriate law enforcement agency, in addition to providing whatever assistance it was able to in connection with request for assistance or inquiries made to it concerning stolen securities.
>
> This approach has enabled the Commission to conserve its already overtaxed money and manpower for use in other areas--principally fraud--where its special expertise is more critically needed (Hearings, 1971, Part 1, pp. 185-186).

But despite Chairman Casey's eloquent defense and denial, he subsequently acknowledges in his testimony that the SEC does, indeed, have a role in the governmental campaign being waged against organized crime.

> Mr. Casey. To the extent that organized crime is connected with any aspect of stolen securities, I should mention that the Commission is now participating in the administration's government wide interagency organized crime program.
>
> In order for this important program to have the benefit of our expertise in the securities area, members of our staff have been placed on several of the Department of Justice's organized crime strike forces.
>
> Also, more than a year ago we set up a separate organized crime group in our headquarters office which, among other things, serves as a support group to the strike forces in various localities and also independently investigates and develops organized crime matters on a nationwide basis.
>
> Our investigations have uncovered a correlation between organized criminals who are involved in the manipulation of securities prices, the fraudulent sale of securities and other violations of the laws enforced by the Securities and Exchange Commission (Hearings, 1971, Part 1, p. 187).

In further testimony, he indicates that Chairman Casey is aware of the fact that careful regulation of the flow of paper and the adopting and interpreting of various laws, rules and regulations promulgated by the SEC can have a definite effect on the theft and disposition of stolen securities.

> Mr. Casey. There are a number of areas subject to the Commission's jurisdiction which, while not necessarily relating directly to the theft of securities, nevertheless, may have an impact in that area.
>
> For example, Section 17 (a) of the Exchange Act requires broker-dealers to made and keep such records and make such reports as prescribed by the Commission.
>
> Pursuant to this authority, the Commission has prescribed rules 17 (a), (3) and (4) which require broker-dealers to make, keep current, and preserve a number of specified types of records relating to the transaction of their business. Rule 17 (a) (5) requires the filing of annual reports of financial condition certified by an independent public accountant.
>
> In a number of these recordkeeping areas the Commission has taken and is continuing to take, action which should help directly or indirectly to reduce the stolen securities problem.
>
> ... Recently the Commission announced a proposal that would require broker-dealers, once every calender quarter, to physically examine and count all securities held by the firm, verify all securities in transit or pledge, compare the results of the examination and the verification with the firm's records and post unresolved differences to the firm's books within 7 business days.
>
> This rule should not only assist brokerage firms in obtaining better control over their operations, but should lead to much more prompt discovery of missing securities. This should not only discourage thefts but also facilitate the discovery and prosecution of persons responsible for thefts (Hearings, 1971, Part 1, p. 188).

Quite recently the SEC adopted a new rule which affects both the back office flow of paper and consequently, quite probably the possibility of certificate thefts. Effective January 15, 1973, SEC Rule 15 (c) (3) (3) makes it mandatory for brokerage firms to buy in, for the account of and at the risk and expense of, the customer securities that the customer has sold through the broker but has not delivered to that broker within ten business days after selling date (it is the date of sale that determines the subsequent date of settlement), in good delivery form. One

brokerage firm, Alex. Brown & Sons, offered to its customers this explanation of the possible reasons for and effects of the new rule:

> As you know, all securities sold by customers must be delivered to the broker immediately but no later than settlement date so that the broker may, in turn, deliver those securities to the broker for the buyer on that same settlement date. Those of you who have been active in the securities markets for the past several years have witnessed, from time to time, extensive delays in receiving securities which you have purchased. Many times these delays have resulted from the selling customer not being prompt in the delivering the securities sold to his broker to be processed on through the system and delivered on to you in this case as the buyer.
>
> The Securities and Exchange Commission, by this new rule, is putting real teeth in the requirement for prompt deliver of securities sold by the customer to the selling broker and it should help provide prompt deliveries of securities throughout the system, and of course, ultimately, to you when you are a buyer (Alex. Brown & Sons, 1973, p. 1).

This rule not only strengthens the requirement for prompt delivery, but by so doing, it ensures that the physical handling of the certificates and the location of these certificates will be more carefully monitored, and missing certificates will be missed sooner.

The adoption of this rule and the chairman's testimony before the Premanent Subcommittee both illustrate the power which the SEC has available if it wants to utilize it. Although, as can be evidenced from the mixed results of federal regulation in other fields, federal monitoring and regulating can certainly not be considered a panacea, but surely additional federal regulation and action in the controlling of

the theft and disposition of securities is warranted at this time.

Immobilization of the Stock Certificate

Thus far in the discussion of controlling or eliminating the methods by which stolen securities are disposed of, only the relatively short range proposals designed for immediate implementation have been mentioned. In addition to these and to the long range proposals, there is at least one recommendation which would be considered of medium range rather than either of short or longer term. This proposal has already been partially implemented, but additional steps will have to be taken in the future if this method is to have maximum impact.

The proposal being referred to is the immobilization of the stock certificate, and this procedure must be accomplished in the interim before the long range proposals being proposed can be implemented.

A number of regional stock exchanges have instituted different methods of immobilizing the stock certificate. Perhaps the best known and most widely discussed method, however, is what is known as the Central Certificate Service. The Central Certificate Service is one operation of the Stock Clearing Corporation which is a wholly owned operational subsidiary of the New York Stock Exchange. The Stock Clearing Corporation and its Central Certificate Service are

responsible for all clearing transactions among NYSE member firms. An excerpt from the Operating Procedures Manual of the Central Certificate Service explains how the stock certificates are immobilized.

> Central Certificate Service, Inc. (CCS) is an automated securities depository which enables its Participants to effect securities transactions with a minimal amount of processing and physical movement of certificates.
> Established in 1968, CCS performs a custodial function whereby Participant's accounts are credited with the shares deposited. The certificates representing these shares are registered in the names of a common nominess, 'Cede & Co.' and are held by CCS or a CCS custodian. CCS itself does not acquire any beneficial interest in the shares. Once a Participant has established a security position, he may avail himself of its use for various CCS functions (September 12, 1972).

Generally and simplistically speaking, then, CCS provides an electronic bookkeeping system where the actual stock certificates are not moved when a stock is bought or sold, but entries are made electronically. Like many other newly implemented automated systems, CCS experiences numerous difficulties and breakdowns; some were anticipated, some were not. Robbins, et. al. (1969), offer some observations on CCS beginnings.

> It is too early to evaluate experience with the immobilized certificate in this country. Only recently has CCS become operational. Yet, in the process it suffered more than a normal quota of birth pains. Difficulties were to be anticipated in introducing a wholly new share transfer system; but run-of-the-mill, start-up difficulties were accentuated by the timing of the project's implementation, which coincided with the worse turmoil of the paper-jam. Firms unable to carry on normal business operations were in no position to convert part of those operations to the new system.
> If it be assumed that technical difficulties relating to programming, systems and the like have been largely

> surmounted, then CCS's most insistent need today is to expand its coverage beyond the limited number of NYSE transfers it now processes. The system can help ease the paper-jam only when shares are deposited with the central agency. Then they can be transferred by bookkeeping entries farther than by actual deliver of the certificate. The job is therefore to encourage maximum share deposits in CCS (or equivalent systems) (Robbins, et. al., 1969, p. 110).

The preceding observation (that it was too early to evaluate the functioning of the CCS) was made in 1969. It is granted that this system needed time to establish itself and prove workable and worthwhile. The following article indicates that even in 1971, more than three years after CCS became operational, it was still beset with serious problems. The article has a New York City dateline.

> Information supplied to New York City officials by a U.S. Senate subcommittee has led to the arrest of seven city residents on charges connected with the theft of securities valued at $2.6 million from the New York Stock Exchange's Central Certificate Service.
>
> Six employees and one former employee of the Central Certificate Service--ranging in age from 20 to 25 years old--were charged yesterday with grand larceny, conspiracy to steal stock certificates from the CCS vault and possession of stolen property, according to the Manhattan district attorney's office. ...
>
> According to Murray Gross, assistant district attorney, the case against the seven was developed on the basis of information supplied by Sen. John McClellan (D., Ark.), chairman of the Senate Permanent Investigators Subcommittee of the Committee on Government Operations. Mr. Gross wouldn't disclose, however, the nature, or source, of Sen. McClellan's information. ...
>
> Mr. Haack said that one of the principal factors in the identification of 'the alleged members of the crime ring' was the inventory controls of the Central Certificate Services. He said the service controls its stock inventory by specific certificate number (The Wall Street Journal, May 6, 1971, p. 8).

When discussing this specific robbery with the Permanent Subcommittee during the public hearings, New York

Assistant District Attorney Gross stated that he believed that the thefts from the Central Certificate Service had been made possible because it, like so many of the Wall Street brokerage firms which CCS services, had lax or non-existent security practices. This occurrence serves to illustrate the interrelationship between short term solutions, such as tightening physical security, and the longer range changes proposed for the securities transfer system. Clearly, no improved system will be foolproof, or even better than what has been used in the past, if such measures as tightened physical security are not practiced. Thus, the immobilization of the stock certificate and the increased use of electronic means of bookkeeping are most worthwhile, but like the others, will not stand alone.

Implementation. If the immobilization of the stock certificate is to be pursued, there are several steps that need to be taken or completed for this to be effective. One is to have a universal security identification numbering system. This is needed both for electronic bookkeeping and for security control purposes. The article quoted above included a direct statement from the president of the NYSE that a major factor in apprehending the thieves was that the CCS controls system inventories certificates by specific certificate number. This appears to be most useful as a system and may negate some of the liabilities of certificates held in street names. The major numbering system is the one

established and developed by the Committee on Uniform Security Identification Procedures (CUSIP) of the American Banking Association. Gibbons (1966) advised that this project would take several years and will be accomplished through a number of phases. The first was underway at that time and involves the creation of a stock numbering system. As illustrated by the CCS example, this system is currently in use, and it will be expanded to include all securities. Accounting for securities by specific number should bring better control thereof, and thus, eliminate or reduce thefts. The Committee on Uniform Security Identification Procedures and its parent group, the American Banking Association, did not respond to an inquiry made for this study.

Street Name Registration

With respect to the numbering and naming of the certificates, there is one other issue or problem which has been alluded to but has not yet been fully discussed. This issue is relevant to any consideration of immobilizing the certificate or otherwise altering the way it is handled and processed. This is the question of issuing and keeping the stock certificate in the name of the actual owner, the customer, or having it carried and accounted for in the name of the customer's broker; i.e., street name certificates. Robbins, et. al., offer a definition and some other observations on street name certificates.

> Brokers and banks register shares owned by public customers in street anme, i.e., in the name of the broker of the bank's nominee. Street name certificates are no more negotiable, from a legal standpoint, than other certificates. In practice, however, they are accepted more readily by securities professionals, banks, and transfer agents. Therefore, they are a relatively more liquid instrument. Furthermore, detention of the ceritficate by the broker enables him to make prompt delivery when shares are sold. For these reasons, until the recent paper problems, brokers generally encouraged cash customers to authorize street name registration (Robbins, et. al., 1969, p. 104).

There is an interesting disagreement between the Hearing witnesses concerning the abolition of the use of street name certificates. Almost all of the law enforcement personnel, and a few representatives of the securities industry (primarily the chairman of the board of Merrill Lynch), favor the elimination of street name certificates. Thereby all certificates would be registered and accounted for in the name of the customer; this would create considerable bookkeeping. Most other securities industry witnesses, however, favored the use of street name certificates, pointing out that it aids in the handling and bookkeeping. Several cited the Central Certificate Service as an example of the use of street name certificates and the advantages therein. These witnesses also argued that with immobilization of the street name certificates, theft and disposition thereof would not be as easy as it once had been. The law enforcement witnesses disagreed strongly. Each position is valid. Street name certificates are both easier to handle and more negotiable. In these instances the expert witnesses, the thieves and trafficers of

stolen securities may offer the concluding and prevailing view. These witnesses advised the Permanent Subcommittee that it really did not make that much difference in disposing of stolen securities. In either case it required fraudulent representation and the forging of signatures on stock certificates or on the acknowledgements of ownership for street name certificates. The trafficers stated that neither was too difficult to accomplish; either was just viewed as another routine step in the disposition process (Hearings, 1971, Part 2).

Machine Readable Certificates

Another proposal for altering the stock certificate is to change the form of the current certificate to one that is machine readable or a punched card stock certificate. Either of these would utilize current electronic data processing techniques. Again the chairman of the board of Merrill Lynch was the major advocate of this type of change, and he pointed out how effectively banks have utilized computerized bookkeeping for checking accounts and have even used them for savings account and eliminated passbooks. He feels that the securities industry should follow suit. However, he did acknowledge that this should be only an interim step.

Robbins, et. al. (1969), discussed both the machine readable certificate and the punched card certificate, and their study concluded the disadvantages outweighed the advantages:

These benefits endow the machine-readable certificate with considerable appeal.

But, some serious disadvantages must be balanced against these advantages: (1) The complete implementation of this system requires the revising of every stock certificate in the United States. (2) There are serious problems that require protection of the certificate against counterfeiting. (3) If the certificate was stapled or pinned to the wrong agreat of the certificate. (4) Heavy capital outlays would be required for both peripheral equipment to read the certificates, as well as computer facilities. In order to reap all the benefits produced by such a system, all firms would have to possess or use compatible equipment. Only in this way could certificates move freely among the brokerage firms and the banks involved. Many firms already have highly sophisticated equipment that would have to be modified or replaced in order to conform to the proposed system. (5) Finally, in a world in which the technological change is pervasive, the idea of substantial expenditures for new systems and equipment that might well be short-lived is untenable. An EDP system to handle machine-readable certificates might well become obsolete before fully implemented.

In short, the machine-readable certificate probably will not be the terminal point in efforts to minimize the burden created by the certificate. It is much more likely to be a step toward the certificateless society (Robbins, et. al., 1969, pp. 85-86).

Elimination of the Stock Certificate

In the above discussions, detailing a major theft of "immobilized" stock certificates from the Central Certificate Service and the numerous liabilities of machine-readable or punched card stock certificates reveal the root of the problems. As long as there is in some form a stock certificate which can be made negotiable, and as long as there are means to dispose of these negotiable instruments, the theft and disposition of stolen securities will continue. The research for this study reveals that there is no final or ultimate

answer to the problems of theft and disposition of securities, but the one, universally made recommendation which comes the closest to resolving and eliminating the problem totally is the one that calls for the elimination of the stock certificate. Clearly, a certificateless society, a term apparently coined by Robbins, et. al. (1969), appears to be a most desirable goal.

Nary a witness appearing before the Permanent Subcommittee favored the retention of the stock certificate in its present form, and almost all of the witnesses favored the complete abolition of it.

The proposed elimination of the stock certificate is a very large undertaking and would be a long term project which would not only require the implementation of new ways of transactioning securities business, but would also in certain instances require the changing of certain state or federal laws. Robbins, et. al. (1969), feel that the best argument for the immobilization of the stock certificate is that it can serve as a lead into the elimination of the certificate completely. Robbins, et. al. (1969), illustrated that although the complete elimination of the stock certificate would be prolonged and complicated, the actual implementation thereof would not be that difficult to achieve.

> The central depository transfer system has demonstrated both the feasibility and the advantages of share transfers without certificate movement. ...
>
> We have already seen that the certificate plays a minor role in most share transfers. It does not affect

the basic sales bargain of the brokers. After the bargain is made, it is used to notify the transfer agent to register the transfer and to issue a new certificate. Its function is relatively insignificant in the traditional system and even less significant in the central depository system. The question then is not whether the certificate is expendable in the share transfer process, but rather, how shares can best be transferred without it. The objective is to devise a means of furnishing the transfer agent with the information currently supplied by the certificate.

The most direct way of accomplishing this is through an electronic system that utilizes advanced technology to effect the locked-in trade. Execution of the order in the marketplace would automatically result in the transmission of essential transaction data to interested parties: the exchange (for transactions in that market), the brokers, and the transfer agent. On receipt of the necessary information, which could be practically simultaneous with the execution, the transfer agent's computer would record the changes required to register the transfer on the agent's books.

Such an electronic share-transfer system would require several elements. The first is a computerized market--a real-time system--that can accept and process transaction-data input at the time the order is executed. The second is a computerized stockholder register that can automatically register transfers on receipt of essential data. The third is a method for transmitting data from the market to the transfer agent, thereby eliminating all obstacles to instantaneous transfer. To accomplish this the computers must be able to talk to one another. This requires, in addition to the pertinent hardware, uniform systems to identify securities (i.e. CUISP), to identify customers and brokers, and to communicate between marketplace and transfer agent. ...

Unlike the central depository share-transfer system that immobilizes the certificate, the certificateless society does not yet exist--at least in the area of corporate shares. ... But there are also substantial similarities. Experience acquired in operating the central depository system should help ease the way to the certificateless society, whether the moon model or some variation.

We also enjoy the benefit of experience in a related field. Many mutual funds furnish a certificate only to a shareholder who demands it. These funds send shareholders a periodic 'Statement of Account' in place of the formal, sealed certificate. Their experience is instructive. Many mutual fund share owners are not financial buffs and therefore might be expected to insist

> on a formal certificate. Their apparent failure to do so argues well for efforts to cut the cord between the public shareholder and the certificate in the equity markets (Robbins, et. al., 1969, pp. 122-123, 136).

Robbins, et. al. (1969), are quite dogmatic in their beliefs that the stock certificate is an anachronism, and that the certificateless society is inevitable; to them it is not a question of if, but one of when. It should be noted that this study of Robbins, et. al. (1969), commissioned by Lybrand, Ross Bros. and Montgomery, is not the only one commissioned during this period to study and evaluate the operations of the securities industry and offer recommendations as to what future action should be taken to avoid the paper work overload and related crises. Three other major studies include the one done by the North American Rockwell Information Systems Company (1969), commissioned by the American Stock Exchange. Another was done by Arthur D. Little for the National Association of Securities Dealers. A third, done by the Rand Corporation (1970), was sponsored by all three major self-regulating agencies: The New York Stock Exchange, the American Stock Exchange and the National Association of Securities Dealers. Of these four, the Robbins, et. al. (1969), report is the only one which calls for the elimination of the stock certificate. The other reports recommended changes in the way the securities does business and that drastic modifications be made in the stock certificate, such as using the punch card format or totally immobilizing it.

Robbins, et. al. (1969), do an excellent job both of anticipating the objections that will be made to their recommendations and of refuting these objections. Before discussing the objections, the description of an average securities transaction as anticipated by Robbins, et. al., will be offered.

> In a typical transaction, as outlined in Chart 15, the buyer or the seller of a stock would place his order through his broker, just as he does today. Let us assume that a customer directs his broker to buy 100 shares of X Corporation stock on an exchange and to register this stock in his own name. Brokers' order forms would differ substantially from forms currently in use and would contain additional information, such as code numbers for the transfer agent and for the buyer in whose name the shares are to be registered. This information would be transmitted to the locked-in trade system. When the trade is executed, transaction results and other pertinent information would be communicated automatically to the brokers for appropriate accounting and record-keeping functions; to the transfer agent for entry in the computerized shareholder's register; and to the SEC and exchange for control or analytical purposes.
>
> How would the change affect the buyer? He would receive the usual confirmation from his broker plus a standard computer printout from the transfer agent. This form, which could be called a Statement of Registered Ownership, would show that as of the close of business on a specific day, the customer (identified by number) was registered on X's books as the owner of 100 shares of common stock. It would also either set forth the terms of the shareholder's contract or would refer A to the charter and other sources of that contract. Thus, the new shareholder would receive information currently provided by the typical corporate share certificate, and he would possess evidence of ownership and a description of his rights. As long as he owned these shares, he would continue to receive period Statements of Registered Ownership. A buyer who directed registration in street name would not receive a certificate under the electronic share-transfer system, just as he does not receive one under the current system. But in the certificateless society the broker's street-name certificate would be replaced by a Statement of Registered Ownership.

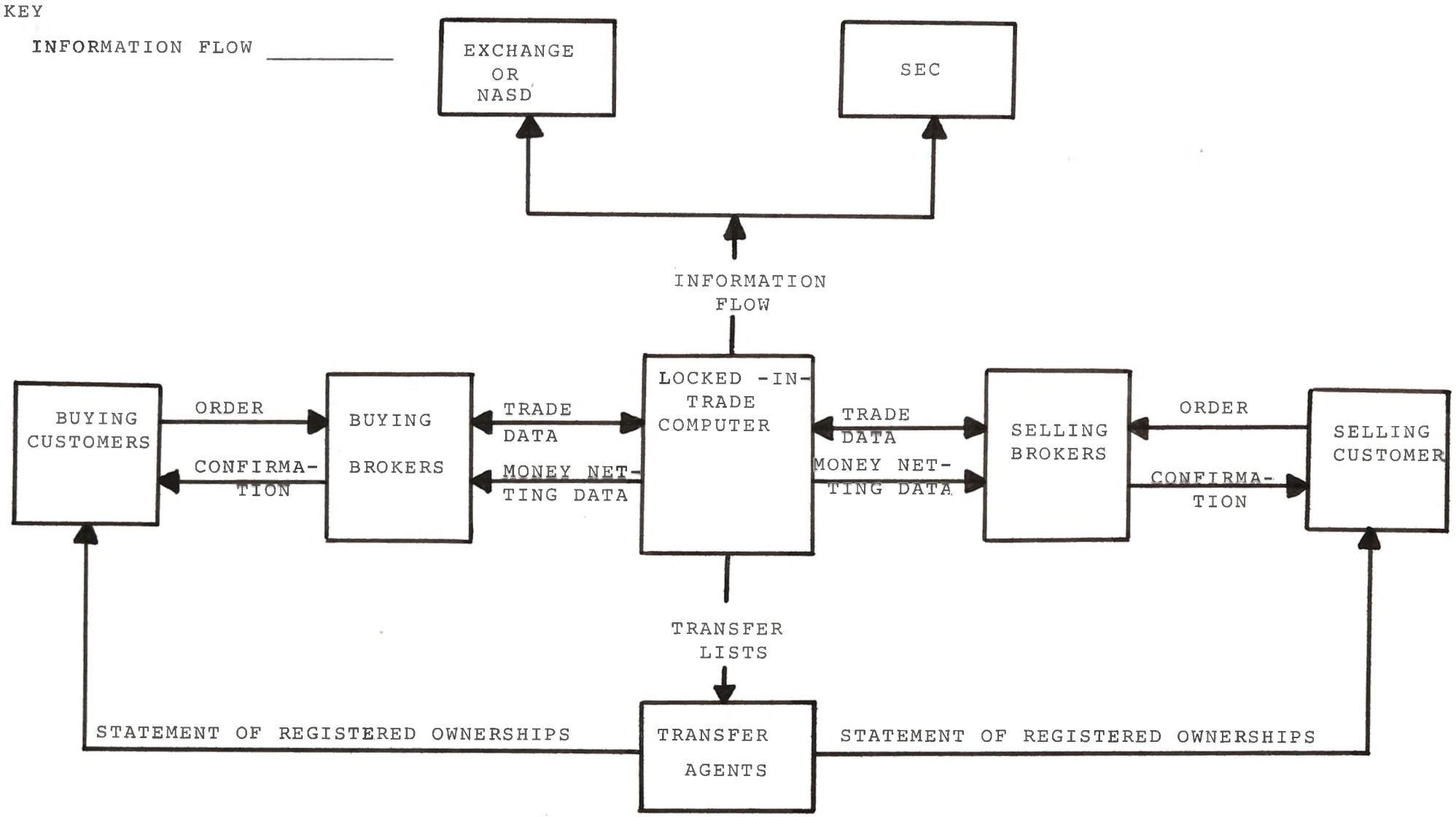
> To the extent required during the transition period to a wholly certificateless society, a similar change would take place in the operation of CCS or an equivalent central depository. The depository would need no custodian: It would no longer hold X Corporation certificates registered in the name of its nominee. Instead, it would carry an account with X Corporation's transfer agent and would receive periodic statements of account. But it is obvious that elimination of the certificate will eventually eliminate the need for a central depository share transfer system. In the certificateless society data for trade of shares held in street name would be transmitted directly to the transfer agent, thus bypassing the depository as an unnecessary intermediate step (Robbins, et. al., 1969, pp. 125-126).

In the above quotation there is a reference to Chart 15. That chart appears in this study as Chart 2. This chart illustrates the flow of electronic information. As explained, this flow of information would eliminate the need for a certificate.

There are, however, a number of instances and business transactions, besides the buying and selling of shares of stock, in which the stock certificate has been utilized. Proponents of retention of the stock certificate contend that it is needed for such things as pledging shares of stock as collateral for a bank or other type loan; the private sale of stock; the giving of stock as a gift; and having shares of stock attached in default or financial failure or in a similar situation.

In discussing these financial transactions, Robbins, et. al. (1969), describe a system which sounds very similar to the checking account system utilized by banks with the

CERTIFICATELESS SOCIETY



funds remaining in one bank or being transferred via paper from one bank to another.

With respect to the pledge of shares, the owner of the stock who wishes to use it as collateral merely signs a Transfer Order, which resembles a bank check. The Transfer Order is implemented by the transfer agent. Similar movements of paper can be utilized for most other business transactions involving shares of stocks and certificates.

Legislation Required

Under the Uniform Commercial Code, shares can be attached or levied only by seizure of the certificate under appropriate legal process. This would have to be changed in the certificateless society. Robbins, et. al. (1969), contend that this old method could be altered so that in the certificateless society these shares would be attached or levied by service of process upon the corporation. They also point out that this is not a novel idea in that the State of Delaware has already divorced intangible share interest from the certificate for purposes of attachment and levy. Robbins, et. al. (1969), believe that this exception to the rule could easily become the accepted practice.

There are other legal problems which Robbins, et. al. (1969), have given very careful attention to. It should be noted that Lybrand, Ross Bros. and Montgomery, the firm which sponsored the Robbins, et. al. (1969), report, held two special seminars on the report and its recommendations. One

seminar was on The Role of Banking in the Elimination of the Stock Certificate (1970); the other was on The Legal Profession's Viewpoint of the Certificateless Society (1970)

According to these studies, there are three sets of legal controls which are of concern to the stock certificate and its elimination. There is the legal requirement of having and issuing certificates; this is detailed in the corporation statutes of each of the fifty states. The second category of legal stipulations pertain to the custody of securities by subsidiaries or others legally charged with holding or dealing with certificates. Statutes in many states required identification and segregation of trust funds, and although these statutes do not explicitly refer to stock certificates, practical interpretation suggests that the language refers to the physical holding of these certificates (Robbins, et. al., 1969). The third area of legal concern is the transfer of shares, and this is governed by Article 8 of the Uniform Commercial Code (UCC).

Each of these areas of legal regulation are given careful consideration by Robbins, et. al. (1969).

> The feasibility of a certificateless society does not insure its implementation. Though the certificate plays a minor role in most share transfers, and no role at all in transfers under a central depository system, it is subject (as noted in Chapter IV), to three sets of legal controls. Each will require amendment.
>
> Article 8 of the UCC will have to be substantially over-hauled. In its present form it would apply to non-equity securities and to corporate shares that, because of size of the corporation or its share market, will continue to be evidenced by a certificate. The Code's recognition

of certificateless transfers in a central depository system paves the way for the legalized abolition of the certificate. But the transfer agent, by-passed in transfers under the central depository system, would play a role in the certificateless society described above. Consequently, the legal standards for transfers based on the certificate must be restated in terms that are meaningful to a system that dispenses with the instrument.

This task can be illustrated by the special problems involved in registration of transfers. Article 8 of the Code today regulates the transfer agent's discharge of the registration function. We have seen how this branch of the law is founded on the certificate, endorsement by the registered owner, and guarantee of the endorser's signature and other 'assurances.' Elimination of the certificate will not eliminate the transfer agent's duty to register valid transfers and to reject all others. To satisfy this obligation, he will need new safeguards to replace those that support the certificate. The 'guarantee of signature' will disappear--there will be no certificate to endorse. But the guarantee function will remain to assure the transfer agent that shares to be transferred are registered in the transferor's name and that he has ordered the transfer. As indicated above, the guarantee will be generated by the guarantor and forward to the transfer agent via the computer programs of the locked-in trade. This will replace the certificate and its accompanying paraphernalia. The guarantee will have to be protected by quality and other controls to ensure fulfillment of the transferor's and the guarantor's objectives, and to eliminate mistakes, theft, and other possible corruptions of the transfer process. The law would have to establish the necessary standards, either by independent legislative action or by incorporating standards established by the securities and banking industries.

Amendment of the law governing share transfer would have to be accompanied by modification of state corporation laws that require the issuance of certificates. Where the law now imposes an unconditional duty to issue certificates, it could be amended to condition the duty on the shareholder's affirmative request for a certificate. This modification would permit the simultaneous operation of certificate-based and certificateless transfer systems during the transitional period that would lead to a wholly certificateless society. The statutes ultimately would be amended to replace the corporation's duty to issue a formal certificate with the obligation to furnish shareholders with the information now included on the certificate. The vehicle for disseminating the information would be the Statement of Registered Ownership discussed earlier in this chapter.

> The third set of legal constraints regulates segregation and safekeeping of trust assets. As indicated in Chapter V, requisite action will depend on terms of the relevant control. 'Security' and 'property' are defined broadly enough in some statutes to permit book entry to replace the certificate. In many instances, however, laws will require amendment to achieve this result (Robbins, et. al., 1969, pp. 136-138).

Holder in Due Course. There is one other legal issue which, since it concerns the disposition of stolen securities rather than the use of the stock certificate, is not covered by Robbins, et. al. (1969). This is what is known as the defense of innocent holder in due course. This defense is offered by those financial institutions which accepted stolen securities in good faith. This defense is predicated upon the Uniform Commercial Code (Art. 8-302) which says:

> Section 8-302 'Bona Fide Purchaser.'
> A 'bona fide purchaser' is a purchaser for value in good faith and without notice of any adverse claim who takes delivery of a security in bearer form or of one in registered form issued to him or indorsed to him or in blank (The Uniform Commercial Code).

James Condon, a vice-president of the Continental Insurance Company who had responsibility for the investigation, adjustment and salvage of claims of stolen securities presented to Continental, appeared before the Permanent Subcommittee. He testified as to the problems an insurer of securities had during the period of high losses because of thefts. The insurers of securities encountered numerous claims of the defense of holder-in-due-course and because of this, took action.

Mr. Condon stated that his company has taken a firm attitude towards those financial institutions which accept stolen securities and take as their defense in these actions the defense that they are bona fide purchasers in due course under the terms of either the Uniform Commercial Code (Article 8-302) or similar law.

At the time of the Hearings, Continental Insurance Company had pending five law suits in different parts of the country against financial institutions who had accepted securities which were stolen from financial institutions which had been insured and redeemed by Continental. Continental's position in these cases was that the receiving financial institution was obligated to ascertain the legitimacy of the certificates being presented.

Neither the citations nor the outcome of these cases is known. Mr. Condon and his employer were contacted for this study, and while replying to it, declined to give any specific information concerning the suits mentioned in the Hearings and other actions taken by the company.

From the testimony of Mr. Condon and from the example of the Wheaton National Bank, previously cited, and from other examples in which the "know the customer" rule proved to be insufficient protection against the knowing or unknowing acceptance of stolen securities as collateral for resale, it is concluded that, if the stock certificate is to be retained, even in an altered form, some legal measures must be taken to

block or limit the holder in due course defense by some means. Banks and financial institutions must be encouraged or forced to exercise greater caution in accepting securities. Perhaps in Article 8-302 of the Uniform Commercial Code the term "good faith" could be more clearly defined, or financial institutions could be required, either through actions of self-regulating bodies or through governmental regulation, to take steps to ascertain the true ownership of the certificates being accepted.

Warehouse Receipts. Other sections of the Uniform Commercial Code, and ones which have received little attention with respect to the securities industry, are the sections which pertain to warehouseman and warehouse receipts.

The Code defines a warehouseman as a person engaged in the business of storing the goods of others for compensation. The custody function performed by brokerage houses and banks could possibly come under this definition.

A warehouse receipt is also defined by the Code.

> Section 19-E Warehouse Receipts
> A warehouse receipt is a written acknowledgement by a warehouseman that the property of a named person has been received for storage. ... The warehouse receipt is a document of title because the person lawfully holding the receipt is entitled to the goods or property represented by the receipt (The Uniform Commercial Code).

Section 19-F of the Code stipulates that these receipts are negotiable. Such receipts and warehousing procedures are often used to store and transfer title of material which is too large to be transported from owner to owner. The

exchange of title to wheat is one example which utilizes this procedure. Along this line of thinking, the transfer of ownership of gold can also be considered. Green (1968) points out that the Federal Reserve Bank of New York is the largest depository of gold, with most of the countries of the world having gold stored there. Due to the balance of payments process, portions of this gold change ownership quite often. Two processes are used. One is a paper transfer; the other is the physical transfer within the bank from the security vault of one country to the vault of another (Green, 1968). According to Green (1968), the security is quite restrictive, and the paper transfer process is quite orderly and well safe-guarded.

The use of warehouse receipts and the extreme security involved in the transfer of gold from one country to another serve as examples to illustrate that exchange of highly valued property can be accomplished without the extensive thefts recently experienced by the securities industry. Therefore, one might assume that if the securities industry is truly interested in eliminating or reducing the theft of securities, it could so do, even without utilizing the radically different procedures, such as eliminating the stock certificate, that are being suggested.

Efforts of the Insurers

Although it is a diversion from the discussion of proposed remedies, it is appropriate to mention at this time

the efforts of the insurance companies to control and reduce the losses from the theft and subsequent disposition of securities. Earlier testimony indicates that many executives in the securities industry were not that concerned about these losses, as they were insured. Robert W. Haack, President of the New York Stock Exchange, emphasized in his testimony the investing public does not bear the burden of securities loss or theft which occurs in a NYSE member firm. Under questioning, Mr. Haack admitted that because of these losses, insurance rates had been raised, and some insurance companies had discontinued insuring certain types of securities.

In 1970 the Continental Insurance Company refused to offer "blanket" bond coverage to the securities industry. The Wall Street Journal of December 10, 1970, reported that the Hartford Fire Insurance Company and the Fireman's Fund, two major securities industry insurers, would not follow Continental's lead and would continue to offer blanket coverage. At the time of the Hearings, Continental Insurance Company representatives advised that they were still offering selective bond coverage only.

All insurers have, however, continued to take many other steps to reduce the loses from securities. In discussing the sizable theft from Morgan Guaranty Trust Company, mentioned earlier, the executive vice-president of that bank acknowledged that it was at the insistence of their insurance company that the bank made their public disclosures. The

evidence presented at the Hearings indicates that for the thefts and subsequent disposition of securities to be curtailed, public disclosure is mandatory. Other witnesses from the securities industry had admitted earlier that many firms failed to report thefts publicly and would only file insurance claims because they feared a loss of confidence in their particular firm. The insurers have been at the forefront in obtaining public reporting and disclosure. They have also been strong advocates of strengthening the physical security in the securities industry.

It was also the insurers who recognized more quickly that eventually it would be the investing public which would bear the ultimate cost of securities theft losses through increased insurance cost, the inavailibility of insurance, and the ultimate loss of confidence in the securities industry.

Reconsideration of the Elimination of the Stock Certificate

Now, after considering the legal issues involved, the prime recommendation of eliminating the stock certificate will be reconsidered. Several specific questions need to be answered. The first is, is elimination of the stock certificate possible? The answer to that question, based upon Robbins, et. al. (1969), and related research is a definite yes.

The second question is, will those private and governmental bodies, with the power to do so, take the necessary steps to bring about the abolition of the stock certificate?

This is a more difficult question to answer. Robbins, et. al. (1969), allude to an answer.

> Both experience and philosophers teach that the rational does not necessarily become the real: institutions have a way of enduring beyond their reason for existence. The certificate-based share-transfer system is a prime example of this observation. The feasibility of a certificateless society does not ensure its implementation (Robbins, et. al., 1969, p. 136).

Clearly the elimination of the stock certificate appears to be the most desirable alternative, both with respect to securities industry operations and with respect to the reduction and/or elimination of the theft of securities and their subsequent disposition. Whether this will be accomplished is quite problematical. No definite answer can be given. Given the research and evidence presented, however, there is little or no doubt that the stock certificate has outlived its usefulness. But because of its long history, it will be most difficult to abolish completely the stock certificate. It can be surmised, however, that the stock certificate, as it is known today, will certainly be drastically modified in form or will be relatively immobile.

The final question to be answered is, if the stock certificate is eliminated or if it is radically modified or immobilized, will these actions effectively solve the problems of theft and disposition of securities? If forced to answer that question in a single word, the answer would have to be NO. One witness appearing before the Permanent Subcommittee, James Beardsley, a vice-president of a leading insurer,

discussed computerization and indicates that theft will always be a problem as long as there are people with motivation for stealth.

Mr. Beardsley stated that he considered computerization in the securities industry a progressive step, but he testified that he is convinced that ways will be found to steal via the computer. He emphasized that man's ingenuity is more flexible than any computer, and he predicted that theft by computer, by feeding in false data, etc., may be the crime of the future.

It would appear that the future has arrived. Gage (1971) reports that Meyer Lansky, a widely known organized crime executive, has been quite successful in recruiting graduate business school graduates, young certified public accountants and other bright young men into the ranks of organized crime; reportedly some of these employees know for whom they work, but many do not. Gage (1971) also notes that Lansky and those he trains are expert in the art of being invisible. It may be possible to assume that these employees are capable of perfecting these so-called crimes of the future.

One such crime has recently per perpetrated. On March 27, 1973 (The Dallas Morning News, April 15, 1973), the New York Stock Exchange suspended trading in the Equity Funding Corporation of America. Subsequent disclosures have revealed that uncovered was the fact that Equity Funding issued at least 56,000 fake insurance policies--issued, sold

and used as collateral. These policies had a face value of $2.17 billion and additional discoveries are expected. Reports from the investigation indicate that fake computer entries and other manipulations of computer information were used. One comment contained in a newspaper account of the Equity Funding case indicates that the problems described and discussed in this study, which primarily covers the period from 1965 to 1971, have continued since that time.

> Confidence is waning in banks which loaned money to Equity, auditing firms which attested to the company's soundness, state and federal regulatory agencies which failed to uncover the scandal which was open knowledge to sources of Equity employees, and security checks set up by the New York Stock Exchange which reacted three weeks after the story was first told to a Wall Street analyst (The Dallas Morning News, April 15, 1973).

Consequently it can be deduced that elimination of the stock certificate will not resolve totally the problem of theft of securities and their subsequent disposition or other crimes involving the securities industry.

However, this does not mean that the remedies suggested by the experts in the field and analyzed in this study should not be tried. To do nothing because failure is predestined would surely be worse than to make attempts which may fail. President Nixon, in campaign and other speeches, has talked about the war on crime waged by the peace keeping forces against the criminal forces. The weapons available to the peace keeping forces described herein seem to be on considerable merit, and it is concluded that they should be used in

attempting to stop the theft and disposition of securities. If they do not work, or if the ingenuity of the criminal forces changes the nature of the battle, then the securities industry and law enforcement community will just have to attempt to devise new weapons. The battle may never be won, but it apparently can be contained. Based upon the evidence presented and research done for this study, it can be said without (it is hoped) of being considered too much of an alarmist, that the financial security of the industry, and consequently that of the country, is dependent upon the war at least waged, if not won.

Summary of Conclusions and Recommendations

From the foregoing it can be surmised that the losses from the thefts and subsequent dispositions of securities are considerable. Yet there are existing remedies and controls, which if implemented by the responsible agencies and organizations, would significantly reduce these losses. Many of the proposed remedies have been discussed here. Table 7 reviews the major conclusions and appropriate recommendations in tabular form. Also indicated in the table are those agencies and organizations which would bear primary responsibility for implementing these recommendations.

All of the recommendations given in Table 7 should substantially effect the theft and subsequent disposition of securities. The final recommendation, which calls for the

complete elimination of the stock certificate, is the only one being offered which would remove the single piece of paper which makes the theft of securities and their subsequent disposition possible.

TABLE 7

Conclusions and Recommendations

Conclusions	That the physical security within the internal operations of the security industry has through 1970 been lax and ineffective.
Recommendations	That steps be taken to strengthen this physical security by: more careful selection of personnel; by fingerprinting employees and conducting background investigations of employees; by tightening the controls on the movement of paper within the industry.
Organizations Responsible	Individual brokers and dealers and their self-regulating bodies.
Conclusions	That law enforcement efforts and subsequent disposition of securities are uncoordinated and regional or local in scope while those stealing and disposing of stolen securities appear to be organized and national or international in scope.
Recommendations	That the theft of securities from any broker or dealer who is a member of the Securities Investor Protection Corporation be made a federal crime. That the federal law enforcement efforts with respect to stolen securities be studied to determine which federal agency is responsible for which aspect of the theft and subsequent disposition of securities. That the federal law enforcement efforts with respect to stolen securities be coordinated by the existing federal agencies or that these efforts be consolidated under the direction of a single federal agency.

TABLE 7--(Continued)

Organizations Responsible
Various branches of the United States Government, to include several agencies within the executive branch, and the legislative branch.
Conclusions
That one of the major sources of stolen securities has been through thefts from the U.S. mails, primarily at large airports.
Recommendations
That more secure methods of mail handling and transportation be utilized, such as the containerization-convoy system currently being used at selected airports. In addition, it is recommended that the U.S. Postal Service and the airlines through which much of the mail is transported, by more selected in the selection of personnel.
Organizations Responsible
The U.S. Postal Service, with the required cooperation of the airlines industry.
Conclusions
That stolen securities have, in the past, been disposed of with ease, primarily because the receiving brokerage houses and banks have not known that the securities were not owned by the persons presenting them for sale.
Recommendations
That nationwide, computer based systems which list and identify stolen property, such as the National Crime Information Center and the Securities Validation Corporation be utilized more fully and effectively.
Organizations Responsible
The U.S. Department of Justice which operates the NCIC.

TABLE 7--(Continued)

Organizations Responsible (Continued)

Individual brokers and dealers which could be required to subscribe to the Securities Validation Corporation by their self-regulating agencies.

Note: As presently constituted the NCIC is available only to accredited law enforcement agencies and private firms do not have direct access to it.

Conclusions

That many of the stock certificates stolen are stolen while being transferred from the seller to the buyer by their respective intermediaries.

Recommendations

That stock certificates in transit be identified as such by stamping or otherwise marking them "For Transfer Only."

Organizations Responsible

The Securities Industry, particularly the self-regulating agencies and various banking associations.

Conclusions

That the internal and external auditing procedures have proved inadequate for the quick and accurate detection and identification of securities as being stolen.

Recommendations

That internal and external audits be more inclusive to include the physical counting of securities and the verification of legitimacy and ownership.

Organizations Responsible

The Securities Industry, the banks concerned, independent private auditors, and those federal and state agencies with audit responsibilities.

TABLE 7--(Continued)

Conclusions
That, for any number of reasons, the federal regulatory agency responsible for overseeing the securities industry has not exerted sufficient leadership and control with respect to the theft and subsequent disposition of securities.
Recommendations
That, under its existing powers, the Securities and Exchange Commission exert more interest and control in the theft and subsequent disposition of securities by issuing guidelines and rules, especially with respect to transfer of stock certificates and the associated movement of paper.
Organizations Responsible
The Securities and Exchange Commission. If additional powers are required, legislation would have to be enacted by the U.S. Congress.
Conclusions
That many of the thefts of securities occur while the stock certificates are in transit.
Recommendations
That the stock certificate be immobilized and the transfer process be centralized.
Organizations Responsible
The self-regulating agencies within the securities industry.
Conclusions
That immobilization of the stock certificate is only an interim solution, and that the stock certificate is no longer a useful document in the sale and purchase of securities.

TABLE 7--(Continued)

Recommendations

That the stock certificate be eliminated and some type of electronic, computer based, real-time system of stock transfer and record keeping be adopted.

Organizations Responsible

All facets of the securities industry and many governmental organizations would be involved. Both additional state and federal legislation would have to be enacted.

FOOTNOTES

FOOTNOTES

[1]The computation is based upon the figure of $44.80 which was the average price per share as of April 30, 1971.

[2]The computation is based upon the figure of $44.80 which was the average price per share as of April 30, 1971.

[3]The author of this study was employed as a Parole Agent with the Commonwealth of Pennsylvania's Board of Probation and Parole from April, 1967, through July, 1969. The records of the Board of Probation and Parole reveal that during this time, Mr. Riccobene was on parole, having been convicted of a drug trafficing charge. For the last twenty months of this author's employment, he was supervising agent for Harry Riccobene, Pennsylvania Parole Number 6184-E. During this period, in order to facilitate the supervision of Mr. Riccobene, the author was given limited access to the files of the Intelligence (Organized Crime) Unit of the Philadelphia Police Department and the files of the Philadelphia Office of the U.S. Justice Department's Organized Crime Strike Force. During this period Mr. Riccobene was employed as the vice-president of John's Vending Machine Company in which Angelo Bruno was listed as salesman. Angelo Bruno is reputed to be the head of the Philadelphia "family" of organized crime. During this period under the supervision of this author, Mr. Riccobene was also listed as the vice-president of the Institutional Mortgage Company of Philadelphia; he held this position at the time of his arrest on federal charges pertaining to stolen securities. Mr. Riccobene is currently confined at the State Correctional Institution at Graterford, Pennsylvania, completing his original sentence for state narcotics violations. Upon completion of this sentence for state narcotics violations, he will be transferred to a federal correctional institution to serve the sentence mentioned by Attorney General Mitchell. Becuase of this personal experience, the author is quite willing to credit the testimony of those who describe organized crime's involvement in stolen securities, and he is reasonably sure that Mr. Riccobene is indeed a member of a "family" of organized crime.

[4]On March 11, 1973, this author received a letter dated March 8, 1973, from Gerald Caswell, Manager of Protection Services for Merrill Lynch, Pierce, Fenner, and Smith in which he outlined the functions and duties of the Protection Services Division of Merrill Lynch. This information was in addition to the testimony provided to the Permanent Subcommittee by witnesses from Merrill Lynch appearing at

the Hearings. On June 14, 1973, this author spoke by telephone with Mr. Caswell. In this conversation Mr. Caswell advised that Merrill Lynch and others within the Securities Industry are using the services provided by the Securities Validation Corporation, but, as yet, less than half of the brokers and dealers that could avail themselves of this service, are so doing. He emphasized that until the majority of the brokers and dealers subscribe to the Securities Validation Corporation services, the service is inadequate and incapable of providing all necessary information with respect to identifying stolen securities as such.

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