DETECTING ILLEGALITIES:

A PERSPECTIVE ON THE CONTROL OF SECURITIES VIOLATIONS

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ABSTRACT

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This dissertation inquiry is located at the intersection of the studies of organizational intelligence and deviant behavior. Its focus is upon the process by which individuals or organizations go about gathering information about the deviant behavior of others, specifically, how they go about "detecting illegalities."

The way in which deviant behavior is socially organized has implications for its vulnerabilities to intelligence. White collar offenses are fascinating in this regard, because of the common longevity of their activities, their organizational complexity, the subtlety and ambiguity of their execution (often accentuated by cover-up techniques), their distinctive patterns of victimization, and the like. The vulnerabilities of white collar offenses are often substantially different from those of traditional offenses, and, therefore, the study of their investigation enriches the body of theory on intelligence and social control. This analysis considers the relationship of behavioral vulnerabilities to the nature and organization of intelligence and the consequences of differential access to behavior for the output of intelligence systems.

These ideas are evaluated through a study of the enforcement activity of the United States Securities and Exchange Commission, based primarily on data from a random sample of over 500 docketed investigations instituted by the SEC

between 1948 and 1972. Data were gathered through systematic coding of extensive investigative records maintained by the Commission.

The dissertation actually contains two ancillary mini-studies, developed to provide background on the Securities and Exchange Commission and on securities violations. One mini-study pertains to the social organization of securities violations, and the characteristics of offenses, offenders, and victims subject to SEC investigation. The other concerns the organization of the SEC with respect to enforcement, the way in which investigations arise, are conducted, and are disposed. Of particular concern is the source of SEC investigation: intelligence based on surveillance, incursions into the securities world (through inspections, filings, and spin-offs) and referrals from insiders in illegal activity, investors, members of the securities community, and other social control agencies.

Because different detection strategies have differential access and sensitivity to particular offense vulnerabilities, powerful correlations between investigative source and offense characteristics were hypothesized. The research findings support these hypotheses. There are substantial differences by detection method in the substantive nature of offenses, their temporal characteristics, their apparency, and the means by which they were executed; in offender constellations and characteristics and their prior relationships to the SEC; in the extent and patterns of victimization, the economic magnitude of offenses, and overall offense significance; and in the accuracy of the intelligence generated.

The dissertation ends with a consideration of strategies for the expansion of intelligence technologies, of legal and moral limits to intelligence, and of the implications of the organization of intelligence systems for enforcement policy.

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cers. In contrast, a complex stock manipulation scheme may be unrecognizable to investors but easily detected by SEC market surveillance efforts. Ponzi schemes and stock manipulation differ on two dimensions: subtlety and "publicity." Because stock manipulations are ultimately more subtle than ponzi schemes, investors are more likely to be unwitting and, thus, less likely to transmit intelligence to the SEC. Since stock manipulation typically pertains to securities traded on exchanges or over-the-counter -- since they employ public media -- they are more readily accessible to SEC surveillance than are ponzi schemes which may involve a small number of investors solicited in face-to-face interactions. One would expect, then, that the ratio of the proportion of offenses uncovered by investors (and referred to the SEC) relative to the proportion uncovered by SEC staff themselves would be very high for ponzi schemes and very low for stock manipulation schemes.

The two offenses, then, are differentially vulnerable to intelligence efforts. Since this study pertains only to SEC docketed investigations and, hence, only those <u>detected</u>, the data say nothing about differential vulnerabilities of offenses to detection of <u>any</u> kind -- of the characteristics of offenses than render them less detectable. But the data have a great deal to say about <u>how</u> and <u>when</u> these detected offenses are uncovered.

The sample of docketed investigations reveal six major ways in which SEC investigations emerge: through (1) SEC surveillance efforts (of the securities exchanges and of the market generally); (2) SEC "incursions" into the securities world (through broker-dealer inspections, the examination of routine registrant filings, and the spin-off of unrelated offenses uncovered during on-going investigations); (3) referrals by insiders in illegal activity (participants, employers of participants, and corporate self-disclosures); (4) referrals by actual and solicited investors; (5)

referrals by members of the securities community (securities professionals and other informants); and (6) referrals by other social control agencies (federal, state, and self-regulatory).

The data reveal powerful relationships between detection method and offense characteristics. There are substantial differences by detection method in the substantive nature of offenses, their temporal characteristics, their apparency, and the means by which they were executed; in offender constellations and characteristics and their prior relationships to the SEC; in the extent and patterns of victimization, the economic magnitude of offenses, and overall offense significance; and in the accuracy of intelligence generated. For example:

- Substantive Violation: Detection strategies array themselves in four different patterns with respect to substantive violation:
  1) these strategies (filings, self-disclosures, referrals from self-regulatory agencies) uncover a disproportionate number of technical violations;
  2) these strategies (market surveillance, spin-offs, referrals from informants) uncover a disproportionate number of the more subtle offenses of stock manipulation and self-dealing and a disproportionately small number of technical violations;
  3) these strategies (non-market surveillance, referrals from investors, securities professionals, state and federal agencies) detect elements of securities fraud involving misrepresentations and registration violations;
  4) these strategies (referrals from insiders and actual investors, inspections) detect offenses involving misappropriation, either exclusively, or in combination with registration violations and misrepresentations.

- Organizational Type: While 87% of the surveillance methods uncover offenses involving stock issuers, this is true of only a third of the incursion generated cases. While 74% of the incursions and 50% of the referrals from the securities community pertain to broker-dealers, this is true of only about 17% of the referrals from state and federal agencies.

- Organizational Size: Surveillance methods are most likely to detect the offenses of large organizations. The ratio of medium or large to small organizations is 4.50 for market surveillance and 1.00 for non-market surveillance, relative to 0.48 overall. Some of the major detectors of substantively significant securities

fraud seem to be uncovering offenses of small organizations. The large/small ratio of cases referred by participating insiders, investors, and other agencies is less than 0.60.

- Number of Offenders: The detection methods most likely to uncover offenses with large numbers of participants include participating insider referrals, a third of which pertain to five or more offenders, market (27% of them) and other (32%) surveillance, spin-offs (22%) and actual investors (20%). The detection strategies unlikely to net many offenders include inspections, 54% of which pertain to one or two offenders, filings (60% of them), and referrals from self-regulatory agencies (55% of them).

- Economic Magnitude of Offense: The detection methods of inspections, filings, and self-disclosures are most likely to uncover offenses in which there are no associated economic costs. The really big cases in economic terms are most likely to be generated by non-market surveillance and participating insiders, 27% of both of which involve offenses in which in excess of $500,000 is at stake, in contrast to 9% of the sample overall.

- Victimization: For more than half of all incursion cases (especially filings) no victims were generated by detected offenses, in contrast to 13% of all cases referred by investors or 18% of those derived from surveillance. Offenses with large numbers of victims are most likely to be detected by participating insiders, non-market surveillance, informants, and solicited investors.

- Rapidity of Detection: An unusually high proportion of offenses detected by surveillance (23%) and incursions (25%) have been ongoing for less than two months in contrast to unusually high proportions of insiders (35%) and investors (33%) who refer offenses ongoing for more than two years. The most rapid detection methods include solicited investors, market surveillance, filings and self-disclosures. The slowest methods include actual investors, employers, participating insiders, and federal agencies.

- Accuracy: The least accurate strategies include surveillance, incursions, and referrals from the securities community; the most accurate include investors and insiders. The proportion of inaccurate intelligence is highest for market surveillance (36%), informants (32%), and filings (27%), and lowest for non-market surveillance (6%), inspections (3%), insiders (5%), investors (6%), and state agency referrals (5%).

- Offense Significance: Those detection strategies most likely to uncover significant offenses include participating insiders (80%), employers (75%), state agencies (76%), non-market surveillance (62%), actual investors (64%), professionals (61%), and informants (55%). In contrast, 74% of all filing matters are at best insignificant, as are 49% of the inspections, 48% of the self-disclosures, 44% of the solicited investors, and 43% of the self-regulatory agency referrals.

The manuscript specifies other findings of the kind illustrated here with greater depth and precision. When the whole set of relationships between particular types of detection and particular characteristics of securities violations are evaluated, it is apparent that there is little redundancy in the "catch" of the various detection methods. For example, both non-market surveillance and state agencies net offenses very similar substantively: both are most likely to uncover offenses based on registration violations and misrepresentation. But, in almost every other way, the offenses they detect are different. Relative to state agency referrals, offenses uncovered by non-market surveillance are substantially more likely to pertain to broker-dealers, to involve more organizations, larger organizations, larger numbers of offenders, more substantial victimization and monetary impact, and to be of shorter duration. Although constructing an intelligence system around either non-market surveillance or state referrals may make no difference with respect to the substantive offenses detected, it would make a substantial difference with respect to other qualities of these offenses.

Even among those strategies which contribute some of the more significant offenses investigated, there are important tensions in their intelligence capacity. Those strategies which detect significant offenses in numbers of individual participants may also uncover offenses insignificant in the organizational dimension in participation; those most likely to uncover victim generating offenses may uncover offenses with typically small numbers of victims; those most likely to uncover significant offenses of any kind are likely to uncover offenses which have ended and are stale; those likely to uncover offenses more quickly after their inception are also more likely to generate inaccurate allegations of illegality.

In short, the choice of detection strategies involves important trade-

offs in the nature and quality of offenses uncovered. Each detection strategy provides a unique perspective on illegality and utilizes its own distinctive binoculars and blinders in creating this perspective. In order to assemble an investigative pool that represents some of the most significant offenses and the full range of offenses and offenders over which the SEC has enforcement responsibility, it is necessary to strive for balance in intelligence strategies, not exclusivity.

Finally, the manuscript considers the policy implications of the research and the possibility of expanding intelligence technologies. The research revealed, for example, that many of the investigative sources providing some of the richest intelligence -- insiders and members of the securities community -- were the least frequent intelligence sources. So attention turns to those strategies by which increased intelligence might be secured. Both the possibility of improving existing strategies and of creating new intelligence technologies are explored. Recommendations are based on the most extreme case, assuming that such technological expansion is desirable at any cost, without consideration of economic, legal, or moral impediments. The manuscript leaves the difficult task of evaluating and balancing these costs to the policymaker. Among the recommendations offered are:

- changes in corporate governance
- requirements of corporate "deviance" audits
- expanding theories of culpability
- redesigning and manipulating disclosure incentives
- making unwitting investors witting, investor education
- making better use of on-going investigative intelligence
- making routine investigations of possible recidivism
- educating and sensitizing the securities community, formalizing lines of communication
- creation of a non-market surveillance enforcement unit
- use of covert under-cover intelligence in very special circumstances

The detection of illegalities lies at the core of any enforcement

program, because, by defining enforcement caseload, it places limits on the reach of enforcement policy. The details of gathering an investigative caseload have implications for the likelihood that any one of a number of law enforcement purposes will be attained. Investigative caseload can be utilized to insure general deterrence, to protect investors, to maintain the integrity of the market system, to define the leading edge of securities law enforcement, to announce a new area of future law enforcement priority, to display the most flagrant abuses in hopes of securing new legislation. Particularly where a flexible disposition system is available, whereby it is not necessary to prosecute or severely sanction all investigated offenses, investigative caseload can be utilized to convey all sorts of messages unrelated to a concern for adjudicating a single offense and punishing a specific lawbreaker.

It is the task of policymakers, then, to reengineer and rebalance intelligence technologies in accordance with enforcement goals. This manuscript provides insights about the varying consequences of particular enforcement methods, insights invaluable in the development of intelligence programs that are consistent with enforcement policy.

CHAPTER 1: DETECTING ILLEGALITIES

This dissertation inquiry is located at the intersection of the studies of organizational intelligence and deviant behavior. Its focus is upon the process by which individuals or organizations go about gathering information concerning the deviant behavior of others, specifically, how they go about "detecting illegalities." It is perhaps ironic that sociology, a field built so fundamentally upon a self-conscious methodology for the collection of information about human behavior, has so little to say about the methodologies by which such data are collected in other contexts. We can develop graduate curricula in research methodology, indeed create Ph.D.'s who do little else. But we can say almost nothing substantive about the way in which other social institutions and organizations and their representatives - journalists, insurance adjusters, credit reporting agencies, surveillance systems, spys, private eyes, blackmailers, market researchers, supervisors, the Guinness Book of World Records, parents, spouses, gossips, and, of course, social control agencies - gather data on social behavior.[1]

Organizational Intelligence

There is essentially only a single theoretical discussion of organizational intelligence in the literature (Wilensky 1967, 1968) and that piece was a rather "modest" work even when it was written over ten years ago.[2] Wilensky's major foci with regard to organizational intelligence concern "the determinants of the

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[1]Of course, there are exceptions, and they will be cited and their insights mined later in this chapter.

[2]I am, of course, aware of the vast literature of varying quality on the "intelligence establishment," spies, espionage, CIA and FBI abuses, and the like. These works are often political more than theoretical in tone. Furthermore, they fail to address the question that I pursue here: How can information on human behavior, socially organized in diverse ways, be gathered?

uses of intelligence and . . . the structural and ideological roots of intelligence failures" (1968, p. 319). His analysis centers, then, upon the way in which organizations allocate substantial resources to intelligence, the kinds of experts they retain, and the relationship of organizational structure to the blockage or distortion of intelligence.[3]

The perspective on organizational intelligence adopted by Wilensky concerns the fate of information once it has reached the organization, with little concern for the process by which information was acquired. It is significant that his definition of an intelligence failure excludes instances in which "the relevant message is not in the system . . ." (1968, p. 323). This perspective contrasts sharply with one in which the acquisition process is made problematic, in which intelligence failures are fundamentally failures in acquiring information, in assuring that relevant messages are in the system. For Wilensky, a correlate of intelligence failure is hierarchical specialization in the organization gathering information, whose lower status members conceal and misrepresent information that they pass up the hierarchy so that it bears favorably on their performance (1967, pp. 424-428, 1968, pp. 323-324). For the dissertation analysis, a correlate of organizational failure may be the hierarchical specialization of a system of behavior about which information is being gathered. Organizational structure of this kind may be very difficult to penetrate, and hence the behavior of those atop the hierachy may be virtually concealed.

Another implication of allocating greater attention to the organization seeking intelligence than to that about which intelligence is being gathered, is

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[3]In contrast, in the dissertation analysis, the fact of organizational intelligence is not made problematic. It is assumed that particular organizations must gather information and the question is how they structure this task.

that few distinctions are made about the nature of that information. As described above, organizations may seek information about the "behavior" of individuals or organizations. But intelligence may also seek, and perhaps more typically seek, non-behavioral data. Information may be sought about more or less immutable characteristics of individuals (for example, their ancestry in the Nazi search for biological Jews), the attitudes, feelings, or affiliations of individuals (in social research, psychotherapy, and the McCarthy witch hunts for Communists), or perhaps the resources, plans, or potentialities of organizations (in political and industrial espionage). Although the intelligence process mobilized to learn of each of these phenomena may have common elements, the study of behavior has some peculiar and distinctive problems. In contrast to immutable statuses or resources or commodities with some durability and permanency, behavior is generally episodic, its duration limited, its occurrence unpredictable. Some intelligence strategies that can rely on the relative fixity of their subjects may simply not have the precision and spontaneity necessary to detect behavior.[4]

These contrasts are not intended to demean the orientation of Wilensky's work. Rather, they are meant to suggest significant questions about which the organizational literature is essentially silent. The directions and preliminary insights of such a perspective are suggested later in this chapter.

The Social Organization of Deviant Behavior

One goal of organizational intelligence is the detection of deviant behavior. In this analysis, our goal is to understand how the nature and

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[4]I note with interest some of President Carter's proposals to subvert Soviet intelligence directed at our nation's strategic armament resources. The idea is to bury them underground on tracks that permit one to move weapons around on a pseudo- "underground railroad" system. The strategy, then, is to convert a relatively fixed commodity to a "behavior" which is therefore much more difficult to detect.

organization of deviant behavior pose particular intelligence problems. Like my plea for new perspectives on organizational intelligence, there have been occasional pleas in the deviance literature for a social organizational perspective on deviant behavior and for empirical work that focuses specifically on the nature and patterning of that behavior (Reiss 1966, Wheeler 1976, Cohen 1977). Such a perspective is described most succinctly by Albert Cohen.

> . . .But the fact that, according to the rules of everyday life or courts of law, outcomes are often thought of as acts attributable to particular individuals, should not blind us to the realisation that, in a very important sense, the author of every human happening is an interaction process. One way of approaching any happening is by asking: What are the different constituents, the bits and pieces of action, the intersecting projects of different actors, that constitute the matrix of interaction of which the happening is the outcome? How are they articulated or joined? What are the structures of human relationships that provide the landscape, as it were - the channels and the obstacles - through which and around which the events flow to their terminus? How, in short, is human action arranged or patterned to bring about the result? (1977, p. 97).

Despite, or perhaps because of, these pleas, the appropriate deviance literature is a bit fuller than that of organizational intelligence. There is a monograph that views crime as "work," which brings together material on what criminals do, their methods of operation, the technical and organizational aspects of their work, their careers, life styles, and relationships with each other (Letkemann 1973). The literature in the area of organized crime is especially valuable in its insights on the structure and organization of such activity (see especially Schelling 1967 and Cressey 1972). There have been some good ethnographies about the organization of particular kinds of criminal activities - armed robbery (DeBaun 1950), heroin dealing (Moore 1977), professional fencing (Klockars 1974), and police corruption (New York 1973). Finally, there is some work on the social organization of secrecy: at the macro

level in Georg Simmel's discussion of the secret society (1950) and at the micro level in Erving Goffman's discussion of "strategic interaction" and of the individual's capacity to acquire, reveal, and conceal information (1969).[5]

There are also a few ethnographies on certain classes of white collar crime and certainly a number of case studies of offenses of particular notoriety. But, in general, literature on the social organization of white collar illegalities is even more meager than that of more traditional forms of crime.[6] This is indeed unfortunate because so many of the distinctive features of white collar offenses - their ambiguity, complexity, subtlety of execution (with pens rather than guns), social location, use of elaborate cover-up strategies, and the like - are exactly those most likely to subvert intelligence designs.

In characterizing the social organization of criminal behavior, Cohen suggests that criminal organizations have many of the same problems and concerns as the organization for any other kind of behavior. However, one of the distinctive problems of criminal organization, he suggests, is that of publicity and information control. ". . .all criminal activity is subject to repression, obstruction, and punishment by agencies of criminal justice, and this gives to secrecy and to control over information a very special kind of centrality in criminal organisation" (1977, p. 105).

Some of these issues are explicitly addressed by M.A.P. Willmer in his book, Crime and Information Theory (1970). The focus of this useful, but

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[5]It is unfortunate that Goffman's inciteful work could rarely be utilized in the present analysis. Because Goffman's analysis is set in a game-theory context, he makes so many limiting assumptions - that the subject and the observer are single individuals, there is an explicit knowable observer who is in the immediate presence of the subject, the subject knows he is being observed, and their social interaction is relatively limited in duration - that the ensuing analysis is terribly narrow.

[6]For literature reviews as well as beginnings of a formulation on the social organization of white collar illegality, see Shapiro 1976, 1978b, and 1980.

terribly abbreviated monograph, is on:

> the systems used by criminals for choosing, planning and executing crimes and the systems used by the police for preventing and detecting the work of criminals. For instance, what skills does the criminal need and how are they obtained? Or again, what set of decisions face a criminal when he is engaged in a criminal activity or has committed a crime and is trying to avoid being caught? What information does he require for his planning and where is it obtained? (p. 6).

Willmer portrays the conflict between the criminal and the police as a battle over information. Parties involved in illegal activities emit a "signal," and the quality and organization of the execution of these activities are closely related to the volume of this signal. It is in the interest of offenders to design their activities to minimize the signal they broadcast and to cover the signal with "noise" that they create and contrive. The police are structured as receivers and interpretors of these signals. Their role is to increase the volume of criminal emissions and to dispell the noise that surrounds them.

Both Cohen and Willmer suggest, then, that the social organization of deviant behavior poses some very different and distinctive intelligence problems. This chapter is devoted to exploring the relationship between detection and illegality. It first begins with the consideration of the organization of intelligence or strategies of detection and of the vulnerabilites of deviant behavior to intelligence efforts.

Detection Methods

One element in the class of intelligence methods is that of detection. "Detection" is derived from the latin "detegere," to uncover. Detection, then, refers to that process by which suspicions concerning particular activity are initially uncovered. The detection process should be distinguished from the investigatory process, whose boundaries often overlap. "Investigation" is

derived from the latin "investigare," to trace out, to search into. Detection represents the initial discovery, investigation, the methodical process of examination and inquiry occasioned by this discovery. For some behaviors, the act of detection may require very little investigation (the culprit pulls a gun and shoots the victim through the heart in clear sight of several police officers and many witnesses). For others, the uncovering is relatively easy, but the investigatory process long, complex, and often futile (the burglarized home, the "Son of Sam" killings). Although these activities may overlap considerably and the methods they utilize may be very similar, for purposes of this analysis, the detection, the uncovering alone is of interest.

As described earlier, the literature on the methods of intelligence is rather meager. The following analysis which suggests abstract categories of detection methods is based upon somewhat remote fields with more substantial literatures. In particular, the analysis is built upon the literature of social science research methodology with some contribution from materials on investigative reporting and social control.

The richest literature in which strategies of gathering data about human behavior are explored is that concerning social science research methodology. The most important principles and distinctions developed in this field, when generalized, provide important tools for thinking about detection methods. The diverse research methodology literature almost uniformly proposes a tripartite model of data collection strategies: observational, survey, and archival research. Respectively, one learns of behavior by direct observation, by querying behavioral participants or observers, or by examining records which bear on some aspects of this behavior. More useful labels would differentiate these strategies as involving observation, disclosure, or artifactual exploration.

A fourth source of behavioral data collection should also be considered. It reflects accidental data retrieval, learning of salient behaviors but not as a result of systematic efforts to detect this behavior. For example, a police officer checks a parked car and observes statutory rape (Skolnick and Woodworth 1967, p. 105), or investigates a complaint of disturbing the peace only to discover possession and use of narcotics by the parties subject to complaint. As these examples illustrate, in some instances, the detection of particular forms of behavior may be a "spin-off" of unrelated detection efforts. One may discover other (perhaps unanticipated) behaviors by particular persons while gathering data on some other aspect of their behavior or that of their associates.

This distinction between observation, disclosure, and artifactual exploration concerns whether data are gathered first-hand by the presence of the researcher when the behavior was enacted, second-hand by the disclosure of information by behavioral participants, or whether inferences about behavior must be drawn by artifacts generated by the behavior. For example, assume that one is interested in the popularity of a particular museum exhibit. Observational methods might result in the posting of researchers around the museum, recording the number of persons at the exhibit, their length of stay, the volume of conversation, repetitiveness of viewing, the sequence in the overall museum tour in which persons stop at the exhibit, etc. A disclosure model might result in interviewing or distributing questionnaires to museum visitors or other segments of the population, asking them to disclose their own behavior or that of their acquaintances. Artifactual methods might result in examination of the extent of tile or carpet erosion around the exhibit relative to other locations in the museum (see, for example, Webb et al. 1966).

Each of these strategies, of course, differs in cost, practicality, and

validity of the data collected. Observational and disclosure strategies are inherently reactive; the actual data collection process may affect the behavior in question (see, Webb et al., pp. 12-22). For example, the presence of observers hovering around the exhibit may create an illusory image of popularity and thus induce persons otherwise uninterested to visit it, or by crowding the exhibit with observers may deter persons who dislike crowds from visiting it. Similarly, the act and procedure of questioning visitors may encourage or discourage them to visit the exhibit or may elicit false answers to impress interviewers. These strategies, then, may alter behavior or may record false reports of behavior. Artifactual methods, because they are necessarily removed from the behavior and its participants, are not inherently reactive,[7] but they are inferential, and the inferential process may produce inaccurate data. For example, the floor surrounding an exhibit may be worn, not because the exhibit is popular, but because it is near a restaurant, restroom, drinking fountain, bench, etc.

Consideration of matters of validity and data quality as well as the factors involved in selecting one strategy over another is premature and will be explored later in the chapter. Whatever their strengths and weaknesses, observation, disclosure, artifactual, and accidental sources of behavioral data are rather different in design and execution. Differences within and between these categories are explored below.

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[7]Of course, if actors know that the artifacts of their behavior will be scrutinized, they may alter their behavior to create no or different artifacts. Drug addicts, for example, may avoid heroin injections on their arms because of their knowledge that narcotics investigators search the arm for needle marks. Bribes may be paid in cash rather than checks so that investigators will be unable to reconstruct the transactions by examining cancelled checks and bank records.

Observation

Observational methods are essentially of two kinds: participant and non-participant. The latter involve strategies of learning of behavior without directly participating in it, the former require some involvement of "researchers" in the behavior itself.

Non-participant observation. For many kinds of data collection, non-participant observation is a sufficient strategy. Where behavior is deviant, secret, or private, however, opportunities for the implementation of non-participant strategies are quite rare. Observers (especially those in uniform) are either denied access to private settings for observation, or their presence tends to decrease the likelihood that the behavior will be enacted when they are present. Nonetheless, police officers are sent out on foot or mobile patrol, despite the growing data that suggest that patrolmen do not detect crimes (see, for example, Silberman 1978, p. 207). Officers still go out on stake-outs and tail other vehicles. And researchers (Humphries 1970) and vice officers still observe in men's public restrooms to detect homosexual activity.

Two alternatives to these methods, which seek to overcome the obvious difficulties of utilizing non-participant observations to gather data on deviant acts, include the use of technological surveillance devices - wire taps, bugs, photographic surveillance equipment, hidden microphones, two-way mirrors - and the use of undercover observers. By going under cover, parties may shed their observational roles and with it, the problems of limited access and their deterrence of activities they wish to observe. Observers shed their uniforms or other identifying indicia. They become bar patrons, bartenders, fellow students, doormen, passengers, shoppers. They become "legmen" in the nomenclature of investigative reporting. They do not participate directly in the behavior observed. However, they may adopt roles contiguous to those

directly involved in the behavior, thus facilitating their observational access. They may occupy service or access positions with which actors under observation must often associate. Sting operations, in which police departments set up operations for the fencing of stolen goods provide one example. By playing the role of the fence, undercover officers secure the opportunity of observing and associating with burglars. Where information concerning the embezzlement of narcotics buy money by police officers is sought, observers may play undercover drug pusher roles to determine whether the full amount is paid to the pusher (Sherman 1976, pp. 211-212).

Finally, it is sometimes possible to open private settings for observational purposes. In some instances, the extension of certain social benefits may be associated with obligations for inspection, thus opening private contexts to observation. Customs officers are permitted to open luggage of international travelers in search of narcotics and illegal contraband; regulatory agencies are sometimes permitted on-site inspections of the records and activities of organizations over which they have oversight (i.e. banks, brokerage firms); insurance, welfare, and other beneficiary systems may be allowed access to the persons and properties of beneficiaries to determine entitlement to these benefits. However, the exploitation of this entree is most frequently for archival rather than for observational "research."

Participant observation. Because it binds the observer to the behavior under observation, participant observation insures exceptional data collection opportunities. However, this strategy tends to be much more reactive than non-participant strategies. Participating observers may deter behavior under observation, encourage it, alter its course or generate new patterns of behavior.[8] The manipulation of overt and covert roles and the management of

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[8]The literature, both scholarly and journalistic, on the role of undercover

other details of participation may minimize the reactivity or other validity problems associated with this research method, however.

The social control literature contains a variety of labels pertaining to participant observer intelligence roles. They include the decoy, stool pigeon, agent provocateur, instigator, and field agent (Donnelly 1951, Geraghty 1966, Lundy 1969, Marx 1964, Wilson 1978, Sherman 1978). The labels variably describe undercover roles taken by organizational outsiders or "civilians" (decoy, stool pigeon) and by organizational insiders (agent provocateur, instigator, field agent). What is more important than the subtleties of the different labels or the sectors from which undercover actors are drawn, however, is the nature of the roles played by these participants. Typically, these include (1) direct participants in the behavior itself, (2) collusory roles, and (3) victim roles.

Adoption of these participant roles require some degree of undercover work, of shedding of identities and recreating new ones. The use of the theatrical jargon of role playing is very apt here. For, truly, undercover work is a theatrical performance (see especially Goffman 1959, 1969). James Q. Wilson describes the instigator (essentially an undercover collusory role) as the legal analogue of the con man, who must "enact at periodic intervals a complex drama involving tempting the quarry, setting the hook, playing the line, and finally netting the captive" (1978, p. 48). Where the degree of identity change is dramatic, and the period of undercover commitment is protracted, the actor is said to be under "deep cover." The use of deep cover tactics may reflect the difficulty of penetrating particular behavior systems or the need for a different quality of intelligence (for example, for long term strategic guidance

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agents in shaping and perpetrating illegality is immense. See, for example, Gary Marx's (1974) discussion of the agent provocateur in the context of social movement organizations. Or see Festinger et al.'s (1956) discussion of the possible contribution of the presence of participating researchers in the response of a small religious group to the failure of prophesy.

concerning a pattern of behavior rather than for a more bounded event).

Perhaps because of the extreme danger of reactivity as well as of extensive commitment, occupying the role of true participant tends to be avoided in most intelligence contexts. And, where participant roles are occupied, they tend to be in marginal or lower level non-managerial positions in the structure of behavior under observation. Of course, there are exceptions (see Marx 1974). Many of the abuses charged against American intelligence agencies derive from the use of their staff in central participating roles in the behavior being monitored, for example, FBI agents holding fairly central roles in the Ku Klux Klan (KKK) and the Students for a Democratic Society (SDS).

Often the compromise solution is to place observers in collusory rather than direct participant roles. This alternative is generally available only for consensual forms of behavior that draw parties from different organizational sectors. By posing as one of the colluding parties, the behavior of the other can be observed. Police officers pose as "Johns" to detect prostitution, or as buyers to detect drug pushing. Observers may offer bribes to politicians or other public servants to detect forms of corruption. A recent illustration is provided by the ABSCAM investigation, a sting operation, in which FBI agents posed as representatives of wealthy Arab businessmen, offering substantial bribes to U.S. politicians in return for promises that the officials would use their influence to assist the businessmen. All transactions were videotaped.

Like full participation by observers, their adoption of colluder roles also holds the potential for reactivity. They are vulnerable to charges of entrapment as well. Most likely, however, it is considerably easier to gain entree to colluder roles than full participant roles.

Entree is perhaps easiest for those occupying victim roles. A whole range of parties are usually eligible to be victims, and presumably offenders are less

fussy about their choice of victims than their choice of co-conspirators. Police officers may pose as elderly persons or young women alone to lure muggers or rapists. Sherman describes "actors" playing the role of arrested bums and thrown in jail to see whether they will be "rolled" (their money expropriated by jailers) (1978, p. 44). Recently, a Chicago newspaper set up a bar staffed by investigative reporters to learn about the incidence and patterning of bribe extortion and other forms of corruption demanded by city officials. Posing as a potential victim provides a form of entree for observers. Of course, these are also reactive strategies, and provide easy targets for charges of entrapment. They increase the probability of the behavior under observation, and their conduct may significantly affect the pattern of behavior they ultimately induce.

Disclosure

Disclosures provide data on behavior for which the presence of observers or observational technology are unnecessary. For this reason, they are well suited for reporting on behavior that occurs in private places or impenetrable locations or which is simply very difficult to observe. Reliance on disclosures, then, can expand the access of researchers to behavior considerably. A perhaps extreme example of the use of disclosures where observation is precluded is the difficulty of witch hunters to ascertain the identity of witches, a process which necessitates observation of the ceremonial pact between the witch and the Devil, who is visible only to witches (Currie 1968). The detection of witchcraft was therefore possible only through confession (usually as a result of torture), disclosures by other witches, or by artifactual techniques. These techniques will be described shortly. In any event, disclosures, because they do not require that an observer accomplice be proximate to the salient behavior to gather information concerning it, permit the collection of data on a broad range of activities. Like observational

strategies, those based on disclosure pose problems of reactivity - the act of reporting behavior may alter it. But additionally, disclosures are at least one remove from behavior. They therefore pose rather substantial problems of validity inherent in the "outsider" status of those making disclosures. Hence, disclosures rather efficiently provide data on a broad range of behavior, but data of sometimes questionable validity. These issues are explored below.

Like observational strategies, disclosures may be made by behavioral participants and non-participants, most of whose roles resemble those adopted by observers. Disclosures, then, can be issued by direct participants, colluders, victims, parties that facilitate the behavior or engage in ancillary behaviors (fences, narcotics mules, stock brokers, pimps), parties that are proximate to the behaviors (neighbors, bartenders, doormen, vagrants, family members, school teachers, secretaries), and parties that have some incentive to survey the behavior of others - competitors, reporters, social control "entrepreneurs" (bounty hunters, blackmailers, paid informants). For many of these examples, disclosures were based on direct observations. But often they are based, not on observation, but on prior disclosures (so-called "hearsay") - parents who report on the victimization of their children at school, spouses who reveal information disclosed by their spouses, fences who pass on information provided by burglar clients, etc. - or are based on artifactual methods - an auditor discloses that an examination of corporate books and records is indicative of an embezzlement or self-dealing scheme; a parent reports that the pregnancy of his or her fourteen year old daughter is indicative of statutory rape (Skolnick and Woodworth 1967).

Hence, one way of differentiating disclosure sources is to array them on a continuum or within a typology that distinguishes their distance from the behavior in question: whether they are participants or non-participants, and

whether their data source is based on observation, disclosure, or artifact. Presumably, the potentiality of accuracy in disclosure would decrease as one moved from reports from particpating observers to those from non-participants reporting artifactual data.

Disclosure incentives. These presumptions, however, assume that all social actors disclose all information to which they have access, and do so with honesty, accuracy, and candor. Of course, such an assumption is simply inappropriate, particularly with regard to the reporting of behavior which is deviant, stigmatizing, or carries negative sanctions.[9] For deviant behaviors, we are faced with a dilemma: those whose information is most accurate are least likely to disclose it because of its incriminating character; those most likely to disclose such information are at so great a distance from the behavior physically, temporally, and interpersonally, that disclosures are unlikely to be accurate.

Later in this chapter, the incentives, both positive and negative, for disclosure are examined in depth. Here, I wish only to describe the way in which incentives are manipulated in the design of disclosure eliciting methods. Given the nature of the incriminating behavior being disclosed, it is unlikely that participants will find positive incentives attractive enough to motivate their disclosure. Therefore, the inducements of social control agencies tend to be negative rather than positive. However, many agencies do offer rewards or bounties in exchange for information, incentives which are sometimes attractive enough to entice non-participants and participants only marginally involved to disclose information. Of course, there are many other positive incentives for disclosure, but those rewards are not delivered by social control agencies or

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[9]This kind of problem is addressed more fully in the research methodology literature, particularly in data collection strategies based upon self-reports of "delicts." See Reiss (1973).

those desirous of information. Incentives of that kind are described later in the chapter.

Most social control systems, however, are organized to deliver negative rather than positive incentives for disclosure. They include the imposition of negative sanctions, the threat of imposing them, or negotiation over their imposition as strategies of eliciting information.

Sanction manipulation can be of various kinds, arrangements by which disclosing participants have charges dropped, plead to lesser charges, or are subjected to more lenient sanctions for their participation than are those who do not cooperate and whose behavior is ultimately detected by other means. Rational actors, then, must devise a calculus which evaluates the likelihood of detection by measures other than self-report and the likely diminution of sanction severity resulting from their disclosure. The treatment of the international bribery and questionable payments scandal by the Securities and Exchange Commission illustrates an enforcement strategy of this kind. Corporations which came forward and disclosed their questionable payments and cooperated with the SEC were promised more lenient treatment. More than four hundred corporations came forward with self-disclosures (Kennedy and Simon 1978, U.S. Securities and Exchange Commission 1976).

In other instances, leniency may be applied for some other unrelated offenses for which the disclosee has been charged. Narcotics investigators may agree to overlook burglary violations by addicts who agree to disclose information on their narcotics connections (Skolnick 1967, Wilson 1978).

Another common strategy is applied in offenses with multiple participants. Certain members of this group are threatened with negative sanctions, but are promised that sanctions imposed for their participation will be relaxed if they disclose information. Strategies of this kind have been labeled "approval,"

"twists," "turn arounds," and have included plea bargaining and promises of immunity. Typically, parties who occupy lower positions in criminal hierarchies, who are assumed less culpable for the behavior in question, or who hold collusory positions in that behavior are the most likely candidates for sanction bargaining. Among these candidates, then, are drug purchasers, low level pushers, "mules," couriers, bribe payers, and marginal facilitators.

In some highly participated offenses, especially of the white collar variety, there is often a scrambling among insiders of fairly equal rank and culpability to be first in line at the prosecutor's office to trade disclosure for immunity when they sense that social control agents are about to close in. Because the activities in which they have engaged are terribly complex, it is not always possible for investigators to ascertain relative levels of culpability, and immunity is sometimes given to that party who turns out to be most culpable. When this occurs, it is often impossible to prosecute the less culpable participants who were unable to trade disclosure for immunity.[10]

The "approver," "an accomplice in a crime who turns Queen's evidence in the hope of obtaining a pardon" (Geraghty 1965, p. 66) provides a historical illustration of this phenomenon of sanction bargaining in English medieval law.

> Being arraigned on a charge of treason or felony the approver confessed his guilt and, in order to obtain a pardon, offered to appeal and convict other criminals called the appellees. If the appellees were found guilty the approver was pardoned. If the appellees were acquitted, the approver was hanged. (Donnelly 1951, p. 1091).

Because the testimony of the approver was so self-motivated, juries tended not to convict offenders on the unsupported testimony of approvers (Geraghty 1965,

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[10]In some of these examples, disclosures, about which sanctions are being negotiated, may be utilized by social control agencies for investigation rather than for detection.

p. 67).

Rather than the relaxation of available sanctions as an incentive for disclosure, incentives may reflect the application of sanctions for non-disclosure. This may be done directly through the creation of legal norms. For example, the Securities and Exchange Commission can prosecute registrants for failure to disclose to the agency and stockholders information about corporate status or activities, whether licit or illicit. This may be done more indirectly, for example, when police officers promise to make trouble - often with licensing agencies - for bar owners who do not provide information about some of their clientele, or by threats by other data collectors (journalists, for example) to embarrass parties who do not cooperate in disclosure attempts. In some instances, incentives may involve the resort to physical or psychological torture to extort confessions, information, or the identities of fellow conspirators or deviants - from witches (Currie 1968), Communists, prisoners of war, and the like.

A recent study of federal investigatory agencies (Wilson 1978) provides some interesting data which bear on the issue of disclosure incentives. James Q. Wilson describes the investigative style of agents of the Federal Bureau of Investigation (FBI) and of the Drug Enforcement Administration (DEA), and notes a significant difference between them with respect to their style of intelligence work and their relationships with outside informants. We learn that FBI agents rarely work under cover, that they make considerable use of informants, and that they entice informants with monetary payments. In contrast, DEA agents must do a significant amount of their work under cover and the informants they use are rarely enticed with monetary incentives (although if they are, a substantial amount of money is usually offered), but rather are enticed with the promise of lenient treatment on other charges for which they

have been arrested. Now, it may be that some of these differences are matters of agency style, history, or philosophy. But, fundamentally, the differences reflect the different social organization of narcotics offenses of concern to the DEA and the wider set of offenses over which the FBI has jurisdiction - differences in such aspects of offenses as their duration, social location, the kinds of participants involved and their interrelationships, the diffusion of information, and the like. It is to the impact of these aspects of the organization of offenses on the success of intelligence strategies that the latter part of this chapter is devoted.

Artifactual Methods

Social behaviors often leave artifacts - physical or social byproducts of the behaviors. Some byproducts are clear expressions of the behaviors from which they issue. All pregnancies of unmarried minor women are byproducts of statutory rape. But for some forms of behavior, the creation of byproducts is probabilistic. Statutory rape does not necessarily lead to pregnancy. And most byproducts are indicative of more than one kind of behavior. The full set of pregnancies in the female population reflect premarital, marital, and extra-marital relations, artificial insemination, "test tube" babies, and immaculate conception. Hence, the surveillance of social byproducts for inferences about the behaviors generating them is a tricky business. The statutory rape/pregnancy example is one of the few in which inferences can be made without substantial validity problems.

The artifacts of behavior, then, can be examined in attempts to learn about the behaviors which generated them. In his analysis of "expression games," Erving Goffman introduces the notion of "uncovering moves," in which gamesmen attempt to penetrate the facades that actors create to conceal their behaviors. One standard uncovering move, he suggests, is the examination of "the track that

the subject leaves, his spoor. . ." (1969, pp. 22-23). In other words, he examines behavioral artifacts.

The examples of artifactual detection strategies are vast, some of the most creative of which are described in Webb et al., (1966) in which unobtrusive research methods are elaborated. The following examples describe some of the methods included in the repertoire of those seeking data on deviant behavior. Police officers look for needle marks as indicators of previous narcotics use. Witch hunters test women by attempting to drown them (those who do are not witches) or by piercing them with a needle to see if they feel pain (those who do are not witches) (Currie 1968). Insurance inspectors may check claims for maternity benefits by those also claiming widow benefits or may make unannounced visits to the homes of persons claiming disability benefits to see if their behavior is consistent with their disabililty (Rule 1974). In either case, it is possible for widows to be pregnant or for disabled persons to be repairing their roof. But in most instances, these are not artifacts of the experience of widowhood or disability.

Securities investigators may examine telephone billing records of brokerage firms. The installation of many new phone lines or increased long distance charges may reflect the institution of a boiler room operation. But it may not. Federal officials may institute mail covers of a particular party - a listing of senders and return addresses of all mail received - which may suggest the addressee's involvement with underworld figures or involvement in a mail fraud. But records of this kind may arise from many more legitimate activities.

Securities investigators may survey the stock market - looking for unusual trading volume, stock prices, and the like - potential indicators of stock manipulation or insider trading. But many such patterns may not uncover illegality and many illegalities may not generate patterns of this kind.

Similarly, Bankamericard requires merchants to phone in credit card purchases which are stored on computers, and the buying record of the card holder is immediately scrutinized. If a huge volume of purchases occur on a single day, or perhaps fifty television sets were purchased, officials may suspect that the card has been stolen and is being fraudulently used and have the card confiscated (Rule 1974). But, of course, this pattern of behavior may reflect purely licit (if irrational) behavior.

Of course, the notion that crimes leave artifacts or "physical evidence" is nothing new. The field of "criminalistics," the application of the physical sciences to criminal investigation, is based upon this notion that the artifacts of criminal behavior are important evidentiary tools in criminal investigation (O'Hara and Osterburg 1972, Saferstein 1977).[11] Many of these techniques, however, are used in the investigation rather than the detection of crimes. A contemporary testimonial perhaps to this important role of physical evidence or artifacts in the intelligence process is found in the latest cops and robbers show, the highly successful television series, "Quincy," in which a city coroner goes about the business of solving crimes through the corpses which he must

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[11]One gets a sense for the range of activities involved in criminalistics by a partial listing of the table of contents of a textbook in this field (O'Hara and Osterburg 1972, pp. xvii-xxii): Fingerprints; Foot and Tire Impressions; Tool Impressions; Moulage and Other Casting Techniques; Photographic Optics; Tonal Relations--Fidelity and Contrast; The Chemistry of Photography; Color Problems and the Use of Films, Filters, and Polarizing Screens; Photographing Fingerprints; Ultraviolet and Infra-Red Photography; Stereoscopic Photography; Direction of Force in Broken Windows; Gambling Machines, Marked Cards, and Altered Dice; Ultraviolet and Infra-Red Examinations; X-Rays; Examinations in Automobile Accidents; the Identification of Automobile and Other Glass; Determining Speed in Motor Vehicle Accidents; Chemical Tests for Intoxication; Liquor Analysis; Detective Dyes, Fluorescent Powders, and Radioactive Detectors; Chemical Tests of Power Residues; Detection of Carbon Monoxide and Other Gasses; Blood; Semen Examinations; Narcotics; Inks; Erasures and Obliterations; The Examination of Documents for Invisible Writings; Miscellaneous Document Problems; Microscopy, Photomicrography, Measurement of Refractive Index; Spectrochemical Analysis; X-Ray Diffraction; Color Analysis and the Spectrophotometer; the Electron Microscope.

examine. A less contemporary testimonial is found in Sir Arthur Conan Doyle's popular Sherlock Holmes stories, in which the physical evidence of crimes were exploited by this clever detective.

The examples are endless. The source of artifacts may be derived from observations or disclosures. What is central is that observations or disclosures are of behavioral correlates, not the actual behavior of interest. Data collectors are totally removed from the behavioral setting or from those who make disclosures about it. Behavioral reconstructions are inherently inferential, then.

Unlike observational and disclosure strategies, artifactual methods - by virtue of their distance from the behavior in question - tend to be less reactive. However, many actors, aware of the potential use to which their behavioral artifacts may be put, intentionally destroy or distort them. Much of what is called cover-up is the manipulation of artifacts - destroying or doctoring records, using cash rather than checks, creating slush funds, etc. Hence, behavior may be changed as a result of concern for artifactual detection efforts.

Clearly more central than reactivity problems, however, are those of validity deriving from the inherent inferential nature of artifactual methods - the fact that many identical behaviors issue different artifacts and different behaviors issue identical artifacts. Nonetheless, this strategy may be the only one available where behaviors are highly private (precluding observation) and highly sensitive and well integrated (precluding disclosure).

Spin-offs

Earlier in the chapter, a fourth information generation tool reflecting "accidental" data retrieval - the "spin-off" was introduced. The spin-off was characterized as unanticipated and supplemental information generated in the

process of the detection or investigation of other matters. In the research methodology context, the spin-off is perhaps remotely akin to "snowball" techniques, sampling strategies based on the selection of a few respondents who then refer researchers to other respondents. A few flakes of snow, then, are rapidly rolled into a monstrously large snowball. It is an informational "pyramid scheme" in which a geometrically increasing pool of research subjects are recruited as a result of only a few initial efforts.

The commentary on the use of snowball techniques in the research methods literature provides some useful insights on the role of detection by spin-offs. Snowball sampling techniques are almost universally condemned for generating terribly unrepresentative samples with no parameters by which this unrepresentativeness can be assessed. Whatever biases or idiosyncracies are characteristic of the initial elements, they are reproduced endlessly in the pyramid of elements they generate. The justification of snowball sampling, then, is that, for certain kinds of samples, it may simply be too difficult for researchers to identify or enumerate the full set of informants. Snowball techniques require that one select only a few appropriate members and then ask them to reproduce themselves.[12]

This characterization has several implications for the detection process. First, many detectors are indifferent to the random sampling and representativeness problem[13] - they simply need to make cases. More importantly, detection of secret, concealed, deviant behavior is extremely difficult and any labor saving devices would be terribly valuable. Spin-off methods are based upon the snowballing notion that salient units can probably

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[12]Of course, snowball sampling can be used for other more sophisticated purposes. But this characterization is sufficient for the analogy being developed here.

[13]Although I would argue they should not be.

reproduce themselves better than could outsiders. This is so for two reasons: (1) because many offenders are recidivists, they are themselves good predictors of future offenders; and (2) because "birds of a feather flock together," it is likely that one will find additional offenders in the social circles of known offenders. In short, ongoing investigation processes are more likely to uncover additional offenses than are random shots in the dark. And, therefore, information may be acquired accidentally, spun-off from ongoing investigative efforts.

Reactive and Proactive Means of Detection

A distinction developed in the social control literature differentiates between reactive and proactive detection strategies (Bordua and Reiss 1966, p. 72, Reiss and Bordua 1967, p. 29, Black 1970, p. 735, Black 1973, p. 128). In the context of police work, for which the distinction was developed, offenses referred by victim or citizen complainants are mobilized reactively; those detected as a result of police initiative are mobilized proactively. In some instances, then, police officers obtain information by reacting to the messages of outsiders; in others, information is gathered due to their own efforts. With respect to the detection methods introduced here, observation and artifactual strategies tend to be proactive. Those based on disclosure can be both, but they are more frequently reactive. Those desirous of information can take the initiative in the disclosure process - torture potential informants, for example - or they can react to information provided voluntarily by informants.

The reactive/proactive distinction works reasonably well in the context of police patrol for which it was developed. Police mobilizations tend to be relatively short, spontaneous occurrences when patrol officers are quickly dispatched to meet a complainant or check out a complaint or where they spontaneously stop to investigate some suspicious behavior. But in other

contexts, where detection is developed and nurtured slowly, where numerous persons may contribute to the process, and where a range of different methods may be experimented with - more typical of the work of detectives, journalists, investigatory agencies, or researchers - the distinction is imprecise and less meaningful. The source or impetus of detection effort is clearly a significant variable, but it becomes a single component in a much more complex intelligence process. It is a factor to be considered when there are questions of access to particular kinds of behavior and when one is concerned with the "representability" of behaviors detected to some "population" of behaviors, but it is one of many factors. Before undertaking a more comprehensive analysis of the relationship of detection strategies to their output, attention turns first to a consideration of the vulnerabilities of behavior to the detection process.

The Vulnerabilities of Deviant Behavior

As described earlier, this dissertation pertains to the intersection of organizational intelligence and socially organized deviant behavior. In this section, the vulnerabilities of deviant behavior to intelligence, the problems of information control by criminal organizations are considered. In particular, the vulnerabilities of white collar illegalities to detection are examined and contrasted with those of other kinds of illegal behavior.

I will intentionally avoid presenting a definition of white collar crime here, because it serves no heuristic value in this context.[14] However, one gets a sense for the unique vulnerabilities or resources of a class of illegal activities often thought of as "white collar" by considering an insightful, but ultimately misguided attempt at defining white collar crime. Jack Katz suggests that crimes be differentiated with regard to the problems they create for the

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[14]See Shapiro (1976, 1980) for extended discussions of the conceptualization of white collar crime.

enforcement process (1979b, p. 435). In his definition, the "purest" white collar crimes are those in which:

> white-collar social class position is used (1) to diffuse criminal intent into ordinary occupational routines so that it escapes unambiguous expression in any specific discrete behavior; (2) to accomplish the crime without incidents or effects that furnish presumptive evidence of its occurrence before the criminal has been identified; and (3) to cover up the culpable knowledge of participants through concerted action that allows each to claim ignorance (p. 435).

Katz suggests, then, that white collar crimes are those which are not "situationally specific," lack "presumptive evidence of crime" and involve "concerted ignorance" (pp. 435-439).

These three elements of white collar activity correspond more or less to the three detection strategies introduced earlier in the chapter. Because these offenses tend not to be situationally specific, they are relatively immune to observation; in lacking presumptive evidence of crime, they lack the artifacts of illegal behavior that may provide inferences about that behavior for intelligence purposes; and because parties surrounding illegality concert ignorance of these activities, there are no sources of disclosure. I take issue with Katz on definitional grounds. The fact that many offenses of the white collar variety are invulnerable to traditional detection methods because of these features suggested by Katz's definition is indisputable, however.

In this section, the aspects of illegalities - whether or not white collar - that render them vulnerable to detection efforts will be explored. As in the examination of the Katz definition, analysis will follow up on the various detection methods introduced earlier and inquire about the assumptions about the organization of deviant behavior that are necessary for these strategies to be effective. An additional analytic strategy that will be employed is the consideration of the phenomenon of "cover-up," a concept

popularized by the Watergate scandal. An analysis of typical kinds of cover-up strategies and the qualities of activity or organization over which they are placed should guide us to some of the more typical points of social vulnerability. For example, the strategy of paying "hush money" suggests that there are members of the constituencies of illegality who must be silenced from disclosure. The strategy of "laundering money" suggests that certain commodities contain indicia that identify their source or the transactions in which they have been exchanged which must be washed away.

Three kinds of vulnerabilities inherent in many offenses will be considered: (1) the diffusion of information among the participants in and audiences of these illegalities (and the possibility of disclosure); (2) the observability of aspects of illegal activities; and (3) the extent to which artifacts, records, or indirect indicators of illegal activities will be generated. They are considered in turn.

The Diffusion of Information

The execution of illegal activity often results in the diffusion of information among the participants in and audiences of that activity. In the trivial case, a single offender engages in a "victimless" crime, like self-dealing, and information is contained within that actor. But in more complex and ongoing offenses, whether white collar (like Watergate, Equity Funding, price-fixing conspiracies) or of a traditional variety (like the Brinks robbery or a narcotics smuggling and distribution ring), information is usually diffused among a number of persons occupying a variety of social roles. For white collar illegalities in particular, the size of this informed group can be very large. A significant source of vulnerability, then, is the possibility that such information may be leaked, whether intentionally or inadvertently. In addition to (or instead of) alerting interested social control agencies, leaks

may also result in the alerting of new prospective victims of a continuing illegal scheme. Leaks, then, can threaten the viability of such a scheme even where social control agencies fail to learn of the leaked information.

In the cover-up vocabulary, the possibilities of paying "hush money" or "cooling the mark" pertain to attempts to silence two of the many kinds of recipients of information, in the latter case victims, in the former, participants or observers. There are four kinds of parties to whom information about illegality is most likely to be diffused: (1) insiders, direct participants in and executors of illegal activity; (2) colluders or consumers of illegal commodities in consensual kinds of offenses; (3) more licit indirect and often unwitting participants in illegalities; and (4) the victims of illegality. There is a group of others who, by association or social location, may be privy to some aspect of the offense - residents of certain neighborhoods, bartenders, doormen, etc. - but it is difficult to deal with this amorphous group systematically.

Participants. Not surprisingly, that group most salient in the literature on secrecy is composed of the participants themselves.

> The fact that secrets do not remain guarded forever is the weakness of the secret society. It is therefore said quite correctly that the secret known by two is no longer a secret.

So wrote Georg Simmel in his most insightful characterization of the secret society (1950, p. 346). These insights concerned the problems of maintaining secrets among those who share secret knowledge, the solutions to which pertained to the relationships among these individuals and to the structure of the group they form.

The fundamental strategy in the keeping of secrets, Simmel suggests, is that of sociation (p. 349). Individuals must be bound in social groups to

generate mutual secrecy.

> If they were a mere sum of unconnected individuals, the secret would soon be lost; but sociation offers each of them psychological support against the temptation of disclosure. Sociation counterbalances the isolating and individualizing effort of the secret . . .(p. 355).

Within secret societies, codes of secrecy are developed and enforced with threats of punishment. In addition, new members are socialized to maintain group secrecy (Simmel 1950, p. 349, Cohen 1977, p. 106). New novices in these secret societies must be taught the art of silence. Simmel cites a secret order of the Moluccan Island of Ceram, in which the newly admitted member is enjoined not only to remain silent about his new experiences, but indeed, to refrain from speaking to anyone for weeks (p. 349). For the secret order of the Gallic Druids, the content of secrets were introduced in spiritual songs that took up to twenty years to learn. "By means of this long period of learning before there was anything essential that could have been betrayed, a gradual habituation to silence was developed" (Simmel 1950, p. 350). In more modern accounts of deviant groups, one finds similar evidence of the testing of new recruits and of the gradual entrusting them with secret information.

The ethnographic literature provides numerous examples of the concern for in-group loyalty and for limiting the opportunities for disaffection. The disgruntled employee who blows the whistle on illegality is a significant problem,[15] responsible, for example, for the bursting of the Equity Funding bubble (Dirks and Gross 1974). There are two common strategies of anticipating

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[15]Willmer suggests that police attempt to contribute to or orchestrate conflict among a criminal team after a crime has been successfully completed. One strategy is to plant suspicions in the minds of certain participants that they have been double-crossed. For example, police may prepare exaggerated reports in the press of the size of the haul. Those participants who were not in a position to see the size of the haul may become distrustful of those participants in such a position (1970, pp. 84-85).

this problem. One is to simply keep the staff employed, limiting the opportunity for creating embittered whistle blowers. The second is to make it difficult for participants to leave the organization on their own volition. One method is to hire a staff that is mediocre if not flawed in some ways (for example, alcoholics) or down on their luck, and then overcompensate them (see, for example McClintick 1977 and Miller 1965). Overcompensation generally results in greater loyalty, a tendency to ask fewer questions or overlook certain problems, and neither a desire for nor an ability to afford mobility out of the organization.[16] Another method is to create complicity of staff in the illegality or in other deviant activities, so that their culpability reduces their incentives to reveal the scheme (at least prior to its discovery by social control agencies) (Cohen 1977, p. 106). Sherman reports that police officers who do not participate financially in corrupt activities are often silenced by those who are by entangling them in other formal rule violations, for example, sex with a prostitute when on duty or the acceptance of Christmas "gifts" from protected businessmen (Sherman 1978, p. 46).

A second solution to the maintenance of secrecy among participants in illegal activities is structural. One aspect of the structural solution is a centralization of power typical of many secret and particularly criminal organizations, and the arraying of individual participants across organizational hierarchies (Simmel 1950, pp. 367-372). Centralized power is necessary to insure the obedience of group members. Hierarchically arranged staff help buffer the central leaders from incursions by outsiders.

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[16]As Katz suggests (1979a, p. 301), even the fact of resignation by key participants may alert outsiders to the possibility that something is amiss. He cites the Equity Funding case and the response of one of the officers to the resignation of a key insider. First, he refused to make the resignation public. Later he spread the false rumor that the reported resignation of the insider was a euphemism for the fact that he had been fired (see Dirks and Gross 1974, pp. 73-74).

A second kind of structural solution is the use of organizational structure to hide the identities of group members from each other and from outsiders. Simmel cites some fascinating structural solutions of this kind. He describes an early 19th century Italian secret society, the "Welfic Knights" who worked for the liberation and unification of Italy. Each branch had a highest counsel of six persons who did not know one another and communicated only by means of an intermediary, "The Visible One" (1950, p. 372). He also tells of a Czech secret society, the "Omladina" which was formed in the late 19th century:

> The directors of the "Omladina" were divided into "thumbs" and "fingers." The "thumb," chosen by the members in secret session, chose four "fingers," who again chose a thumb. This second thumb introduced himself to the first, chose four fingers who chose a thumb; and thus the process of organization continued. The first thumb knew all the thumbs, but they did not know one another. Among all fingers, only those four knew one another who were subordinated to a common thumb. All transactions of the "Omladina" were conducted by the first thumb, the "dictator." He informed the other thumbs of all intended actions; the thumbs then issued orders to their subordinate fingers, who relayed the orders to the ordinary members assigned to them (1950, p. 357).

And, of course, there are many contemporary examples of the use of structural arrangements to mask the identities of leaders and to buffer them from others in the organization: the cell structure of the American Communist Party (Selznick 1960), the structure of organized crime organizations of various kinds (Cressey 1972), the structure of narcotics distribution rings (Moore 1977). Goffman writes about the role of organizational structure in the protection of spy networks:

> Hierarchical organization means that one man "in place" near the top can render the whole establishment vulnerable. In the field, lateral expansion through links means that one caught spy can lead to the sequential entrapment of a whole network. In both cases, the damage that can be done by a disloyal member is multiplied. The usual answer is

> compartmental insulation and minimization of channels of communication. But these devices, in turn, reduce coordination of action and dangerously impede corroboration of information (1969, p. 99).

Katz writes as well about the use of organizational structure and position in cover-up plans: to shield members from charges of wrongdoing (1977) and to permit members to concert their ignorance of wrongdoing (1979a).

A related observation is that of the use of interpersonal "distancing" between the central offenders and ultimate actors in illegal schemes through the employment of agents, middlemen, nominees, and the like.[17] As in laundering funds, attempts are made to launder identities - to wash away the offenders' identities by delegating their activities to more licit actors.

The attempt to mask and launder identities is not restricted to organizational leaders, of course. Attempts to "de-individualize" all members of secret societies are common (Simmel 1950, pp. 372-373). The phenomenon is manifested in the use of masks by members of secret orders in primitive tribes and the designation of members by numbers rather than their own names in more contemporary practice (Simmel 1950, p. 373). Of course, this deindividualization serves not only to assure secrecy, but to depersonalize secret organizations as well, to suppress individuality that is often inimical to group cohesion.

The purchasers of illicit services. Another group of offense participants are not members of deviant organizations. They are characterized as the "non-victims" in victimless crimes, the individuals and organizations involved in consensual offenses. Typically, these parties are the purchasers of illicit services: Johns who patronize prostitutes, drug purchasers, gamblers, bribe

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[17] Some recent accounts of this phenomenon as employed by Gulf Oil and the Lockheed Corporation are fascinating (McCloy 1975, Shaplen 1978).

payers. Often their conduct is considered less culpable or less serious by law enforcement agencies than that of the providers of these goods and services. But illicit purchasers usually have at least some information about the organizations which provide the services they consume. They may be unable to identify the parties atop the hierarchies of these organizations. But they usually have information about the fact of an illicit transaction and about the identity of the party with whom they have or will consummate such a transaction.

These "consumers" generally have less information than insiders in these service organizations, but they certainly have enough to disclose information on at least one instance of illegal behavior - that in which they participated. The problem, of course, is that they have few incentives to disclose this information. They have willingly engaged in consensual crimes. They have no "victimization" to report. And any disclosure is likely to incriminate them of illegal or at least deviant or embarrassing conduct. The incentives for disclosure are slim, then, and probably are operative only when the "consumer" has been "burned," defrauded or victimized by those providing them services[18] or when they have been charged or arrested for their illicit "consumption," and a condition of their release without arrest or of leniency in plea bargaining is that they finger those who "supplied" them.

Although the incentives for disclosure are generally low for this class of informants, they vary on the basis of the type of transaction or relationship the consumer has with illicit organizations. Those whose transaction is unitary or episodic may be more easily induced to disclose information than those with long time ongoing relationships. In the area of police corruption, for example,

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[18]For example, a John who is robbed by a prostitute may lodge a complaint. However, many of the kinds of consumer fraud in the underworld necessarily go unreported. For example, a drug purchaser who pays for heroin and is sold milk sugar is unlikely to complain to authorities.

Sherman notes that corruption "events" - discrete one-shot bribe payments - are more likely to be reported than "arrangements" - repetitive long-term corruption arrangements with the same group of bribers. He argues that arrangements are more likely to be consensual, events more likely to create a "victim" role (presumably because bribes in this case are extorted). And victims seem more likely to complain than consensual participants (1978, p. 44).

The most common strategies by service organizations of assuring the silence of these consumers is through the masking of identities and responsibility through organizational structure, the delegation of responsibility, and the anonymity of transactions. Perhaps nowhere is the concern for consumer silence and the precautions taken therefor so great as in the heroin distribution system. In a fascinating account, Mark Moore (1977) describes the precautions taken by drug dealers in the selection of their "clientele." Because of the concern for subsequent disclosures made by drug purchasers as well as the possibility that one may be an undercover agent, drug dealers typically take steps which ultimately have the effect of appreciably limiting the profitability of their business. Dealers typically transact with a very limited number of buyers. Moore suggests that limiting clientele has several advantages for dealers. It means that only a few people have direct knowledge of their activities and reduces a possible leak of information. It permits close monitoring of customer behavior and the possibility to anticipate betrayal. Finally, it permits face-to-face communication between purchaser and dealer and the identification of purchaser interests in keeping the dealer in business. These factors are likely to reduce the probability of information leaks (p. 17).

Two additional measures frequently taken by heroin dealers to diminish the likelihood of customer disclosures are careful screening of potential clients and monitoring and disciplining clients for their subsequent behavior. Moore

suggests that where potential customers are carefully screened - requiring letters of reference, investigating their arrest record, asking other dealers about them, observing their activities - chances of betrayal are diminished (pp. 19-20). Or instead, dealers can monitor customer activities - tail them and observe their encounters, discover their contact with the police by monitoring arrests in newspaper accounts and other records - and then severely sanction betrayal with beatings or murder (p. 20). Although these measures are perhaps extreme, they suggest the problems and strategies of dealing with collaborators in consensual offenses.

Licit collaborators. A third category of offense participants is the licit collaborator. Where illegal events are spontaneous or opportunistic, those parties contributing to the offense are the direct participating offenders. However, where illegalities involve planning and are of substantial duration or complexity, it is likely that goods and services may be required of outsiders. Goods may be required like anhydrous acetic acid, adulterants (mannite, quinine), and containers (medicine capsules, glassine envelopes), commodities distinctive of a heroin distribution system (Moore 1977, p. 15). Or the equipping of a boiler room securities promotion operation may require the installation of banks of telephones. Other offenses may require a variety of services provided by outsiders - promotional services, advertising, distribution, brokering, warehousing, banking, accounting, "lawyering." And, finally, there may be business associates or competitors of illicit organizations who may become privy to information due to business relationships, physical or social proximity, similar clientele, and the like. These differing business associates and providers of goods and services have variable knowledge of illicit activity. They may directly know of illegal activities enacted or anticipated; they may suspect such activities; they may be able to infer such

activities only with great insight, curiosity, and vigor; or they may be truly in the dark. And, likewise, their degree of culpability varies in different relationships.

These predominantly licit associates colluding in illegal activities are the great unknown quantity in enforcement work. The Securities and Exchange Commission believes strongly enough in the likelihood of informational diffusion of this kind, that they have employed an "access points" theory in enforcement work. The notion is that there are a variety of social roles which provide services necessary for successful illegal activities, which provide "access" to these activities. In the case of securities fraud, the most important of these access roles are held by accountants and attorneys. Since these professionals are more limited in number and easier to monitor than the unknown number of potential securities swindlers, SEC enforcement officials have attempted to provide incentives for their disclosure of information, if not for their unwillingness to participate in the first place. These incentives are negative ones, the charging of these professionals with some culpability for the illicit activities to which they contribute, and therefore, the threat of legal sanctions.

The record of success of the SEC access points theory is spotty and not fully tested. Nonetheless, we really do not know the extent to which information does diffuse to such collaborators or the conditions under which diffusion is most likely. Nor do we know how such collaborators can be trained to recognize evidence of illegality or the incentives that would be most likely to insure their disclosure of such information.

<u>The victims of illegalilty</u>. A final category of offense participant is the victim. In many cases, at some point in the course of an offense, victims or potential victims acquire information about aspects of illegality. In some

instances, this point antecedes the criminal event. In the case of burglary, this point is reasonably soon after the event, usually when the victim returns home. For many white collar crimes - embezzlement, swindles, etc. - this point may be years after the offense began. In other instances, particularly fraudulent activities, some information is actually available prior to victimization, when victims are induced to "participate" in their own victimization. In some cases, the victim himself is the informing event, the corpus delicti in the case of murder. And, finally, there are some offenses for which victims remain permanently unwitting of their victimization or for which the consequences of illegality are so diffused that it is difficult to identify victims - for example, political corruption or price-fixing.[19]

The important questions with respect to victims, then, are (1) when and under what circumstances do the victims of offenses possess information about these offenses? (2) when are they willing to disclose this information? and (3) what precautions do offenders take to silence their victims? Although there are some traditional forms of crime where victimization is ambiguous, particularly where illegality is a matter of degree - for example, rape, assault, and some victim-precipitated crimes - or where events can be concealed from victims through sophisticated forms of cover-up, answers to the first question are generally uninteresting for offenses of this kind. It is for white collar crimes that the fact of victimization is typically manipulated and the extent of victim wittingness is indeed problematic.

Elsewhere (1978b), I have developed the idea that white collar offenses

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[19]There is a growing body of literature on victimology, particularly that experienced by victims of traditional crimes. See, for example, Drapkin and Viano (1974), Penick and Owens (1976), Hindelang (1976), and Hindelang, Gottfredson, and Garofalo (1978). The attention to the victims of white collar crime in the literature is substantially smaller, though see Geis (1975) and Vaughan and Carlo (1975).

often involve the manipulation of "trust," a social technology that allows victims to either delegate to others the responsibility for guarding their possessions or to consent to misrepresented transactions in which they are in fact being victimized. In addition, persons or organizations in trusted roles have opportunities for both misappropriation of the assets of others or for self-dealing instead. Various white collar crimes provide several scenarios in which victims may be unwitting:

(a) they may consent to engage in transactions on the basis of misrepresented information;

(b) their assets may be embezzled or misappropriated by trustees;

(c) they may be exploited by the self-dealing of trustees (for example, stockholders of corporations whose officers are making lucrative contracts with other corporations in which they have a financial interest);

(d) they may be engaged in unfair competitive situations - dealing with those who are involved in price-fixing arrangements or who are acting on the basis of undisclosed inside information;

(e) they may be the subjects of more diffused forms of victimization - paying excessive prices for price-fixed goods; paying substantial taxes, insurance premiums or pension contributions, a proportion of which is being lost to fraud and corruption; being represented by politicians whose loyalty is to certain corporate interests rather than to their constituencies.

Of course, the white collar crime scenarios are richer than this brief sampling. But what this sampling reflects is the variety of circumstances in which fraud, cover-up, and diffused relationships may conceal the fact of victimization from victims. And many offenders exploit these manipulable opportunities to even further conceal their acts. They may engage in temporal or physical distancing, further separating the victim from his or her transaction. Since many white collar victimizations reflect a "futures" or

investment context, with payoff promised at some future point, transactions can be protracted and victims lulled while offenders continue to victimize others. Victims may be kept physically distant from commodities in which they have an interest, whether because of their physical location or because offenders have "graciously" offered to provide custodial services for these commodities (i.e. stock certificates, commodity investments) and thus conceal disconfirming information. Generally, as offenses become complex, with many transactions, laundering of funds and relationships, creating distance between victims and the commodities they own and the parties with whom they transact, and as offenses endure longer, it is most likely that victims will remain unwitting.

Of course, some victims do learn of their victimization. Even here, offenders will attempt to insure their silence. One strategy is "cooling the mark out," a process introduced by Erving Goffman (1952) in reference to the problems of persons losing or failing in social roles and the investment of other parties in helping them cope with the loss. The purpose of cooling out the mark is to lessen the likelihood that he will express his anger by complaining to social control agencies. Goffman suggests that the mark be permitted an opportunity to blow-up, for presumably it is better to blow-up at the operator than at others. The mark may be offered another chance to qualify or be offered a different status. An example of the latter is reflected in a securities swindle in which the promotor suggested that victims donate their (less valuable) securities to a charitable organization and then take income tax deductions, thus minimizing loss (McClintick 1977). There may be a variety of victim-offender collusory agreements in this phase. These agreements may pertain to the operator's assistance in obtaining recompense from some external agency (insurance, government) or in passing along the losses to someone else. They may also pertain to the manipulation of stigma. Failure in a role

generally, or being a victim of illegality in particular, is a potentially stigmatizing experience. One appears gullible, stupid, too trusting, and the like. Presumably, the operator can utilize the threat of revealing the victimization to others as a strategy of silencing and securing the cooperation of the victim (a rather bizarre turn of events).

A related form of conspiracy between victim and offender is more utilitarian than cooling-the-mark. That pertains to various arrangements for the payment of hush money. Where the party penetrating the cover-up is the victim, hush money usually takes the form of providing restitution, settling law suits out of court, providing recompense for claims, or repurchasing the commodity and cutting the victim out of the transaction. Generally these agreements are premised upon promises by the victim to drop the charges or remain silent.

The circumstances of disclosure. Earlier in the chapter, the way in which intelligence systems structure positive and negative sanctions to induce the disclosure of information diffused to parties outside the system was described. Here we explore the disclosure incentives of these parties apart from the manipulated sanctions of intelligence systems. What are the circumstances surrounding disclosure? We will continue discussion of the victims of illegality and then consider the incentives of other offense participants and observers.

Of course, the major explanation of victim silence is their unwittingness. To my knowledge, data do not exist on the proportion of offenses in which victims are and remain unwitting of their victimization. But it is probably safe to assume that for most offenses, victims are witting. Given that fact, what is the likelihood that victims will disclose such information to authorities? Data are available that bear on the victims of traditional crimes.

> A sample survey of United States households made by the National Opinion Research Center (NORC) in 1965 showed that more than half of all crimes and 38 percent of the FBI's index crimes against residents went unreported to the police (Biderman, 1967). Other surveys for the President's Commission (Reiss, 1967) and the Small Business Administration (Reiss, 1969) reveal that at least one-half of all major crimes against businesses and other organizations go unreported to the police, particularly crimes of burglary, shoplifting, employee theft, and passing bad checks (Reiss 1974, p. 686).

Estimates based upon the National Crime Panel victimization survey data from 1974 also suggest low rates of reporting to the police, though with substantial variations across types of victimizations. Rates of reporting ranged from 16% of the household victims of larceny of less than $50 to 90% of the business victimizations by robbery. Of the personal victimizations, this range was from 23% reporting attempted purse snatching to 66% for serious assault. Of the household victimizations, completed vehicle theft was most likely to be reported to the police (88%) (Gottfredson, Hindelang, and Parisi 1977, p. 358).

Albert Reiss (1974) has culled the diverse information generated by data sources of this kind, and has made some observations on patterns of victim disclosure. Perhaps most important in the likelihood of disclosure, is the nature of victim property loss.

> The reporting of crimes against property is determined to a great extent by insurance coverage. When a person is not insured against property losses or the losses are not covered by insurance (often the case for the poor), the loss is not reported because the victim sees no personal gain in doing so. Even when there is coverage by insurance, many businesses, and some citizens, fail to report losses because they fear their policy may be cancelled or not renewed or that there will be a future rate increase (Reiss 1969: 131-43). Conversely, insurance coverage is an incentive to report property losses from crime, since some people assume that, to collect on their insurance, the loss must be reported to the police. (Reiss 1974, p. 686).

In the white collar crime literature, conjectures suggest that rates of

victim disclosure increase with the magnitude of victimization. Edelhertz (1970, p. 17) notes, for example, that charity swindles are very resistent to victim complaint because small contributors are unlikely to make the effort to check out representations about the nature of the organization or the use of the proceeds. This may be the logic that underlies the strategy of some operators who limit the magnitude of financial commitment by victims in certain schemes (McClintick 1977). For offenses such as price-fixing, competing firms not included in the price-fixing conspiracy can be subject to substantial economic harm. Data indicate that competitors provide a substantial share of the disclosures on price-fixing (Weaver 1977). The rate of competitor disclosure for other offenses is unknown, but probably not as great.

A second factor involved in victim disclosures suggested by Reiss is the victim offender relationship. The likelihood that victims will call the police is inversely related to the extent of intimacy or the strength of the relationship between victims and offenders (1974, p. 686). A great deal of ethnographic research suggests that disputants in ongoing relationships are more likely to resolve their disputes through informal social control systems, and that recourse to formal law increases with the increasing relational distance of disputants (see especially Black 1976, pp. 105-122). Does this pattern exist as well for patterns of disclosure where the disclosure occasion is not one of dispute settlement? Are people more likely to gossip, break confidences, and the like concerning social intimates or those of greater relational distance?

Finally, Reiss suggests that the likelihood that citizens will report crimes to the police is determined by his or her attitude toward the police (1974, p. 686). In a Washington, D.C. study, one-third of the respondents indicated that they did not report property crime to the police because they felt nothing would be done. Only 3% failed to report because of fear of

reprisal (Biderman et al. 1967, pp. 153-154).

It is unclear whether fear of reprisal or any of the other explanations of the reporting of traditional forms of crime - property loss coverage by insurance, victim offender relationships, belief in the efficacy of social control agencies - apply to the victims of white collar crime. The only other common theme concerning these victims found in the literature is that both individuals and organizations victimized by white collar crime are often "embarrassed" and do not wish to publicly display their naivete or vulnerability and therefore often do not make disclosures (Edelhertz 1970).

So the circumstances surrounding victim disclosures tend to be associated with their desire for recompense. It is not surprising that the customers or licit facilitators of criminal offenders are unlikely to disclose information, since the consequences of such action for them are almost always negative. Licit facilitators wish to keep their criminal clients and have no desire to get involved (especially if they fear reprisals as a result of their involvement). As long as these facilitators are immune from substantial penalties for their collaboration, it is unlikely that they will be reliable sources of information.

The incentives against customer reporting are even greater. First, they have an interest in keeping their suppliers in business. Secondly, if Moore's (1977) account of the extent and severity of disciplinary action taken by heroin suppliers against disloyal customers applies to other consensual crimes as well, client cooperation with authorities is greatly deterred. Presumably, customer cooperation is likely only where the sanctions of social control agencies for their participation in illegality are even greater and more likely than supplier discipline, or where authorities can guarantee their protection from suppliers. A final circumstance for customer disclosure, described earlier, occurs when they are burned or defrauded by offenders and seek vengeance.

The major circumstances under which participating offenders disclose information were described earlier. Disclosure may result from vengeance exercised by insiders who feel exploited, unappreciated, or whose services have been terminated. Or disclosure may come from marginal insiders fearful about their ever increasing complicity in illegal activities. For offenses that occur in an organizational context, there may be nonparticipating insiders working along the margins of illegal activity, who, like licit collaborators, may have suspicions or fragmentary knowledge that the activities surrounding them are somehow illicit. Within this group, there are probably a few who genuinely have no knowledge, a few who are able to concert ignorance (Katz 1979a) despite the fact that they are not ignorant, and a few potential whistle blowers. Of course, there are few incentives to be a whistle blower and rather substantial negative sanctions for this behavior, including reprisals, loss of employment, and social ostracism. It is not surprising that whistle blowers are so rare.

The Observability of Behavior

A second source of the vulnerability of deviant behavior to detection is the extent to which aspects of this behavior are observable to outsiders. In a now classic statement, Arthur Stinchcombe discussed one element of the observability of behavior, its social location. In "Institutions of Privacy in the Determination of Police Administrative Practice" (1963), Stinchcombe describes the legal institutions in modern societies that define public and private places and which restrict entrance to private places by representatives of the state. Since deviant behaviors are allocated differently to public and private locations, they bear different vulnerabilities to police detection through observation. Those kinds of offenses that are more likely to occur in public places (for example, drunk and disorderly conduct) are thus more vulnerable to detection than those that typically occur in private places (for

example, wife-beating). Similarly, the offenses enacted by groups in our society that spend a disproportionate amount of their lives in public places (i.e. the young and the poor) are more vulnerable than those of more privately located persons.[20]

Hence, the vulnerability of illegal activities to detection can be reduced if they can be relocated in private places. Designs of this kind are not that easily implemented, however. For many kinds of consensual crimes, consumers or clients must be recruited, a process facilitated by public conduct - the act of soliciting by prostitutes who locate themselves on the streets, as do many confidence men, drug dealers, and numbers runners; and the act of advertising in newspapers and periodicals by those engaged in consumer or securities frauds. Such public promotional activities can, of course, be limited, where prostitutes become call girls, customers find drug dealers (Moore 1977) or abortionists (Lee 1969) through a referral process constructed from their social networks, or confidence men find their marks via the social networks of potential or previous marks. But the retreat into private locations often entails substantial sacrifices by offenders, reflected in the diminished profits that result from the limitation of clientele.

Of course, for certain offenses, public behavior is unavoidable. In these cases, offenders attempt to blend their activities into licit routines, so that their conduct, though observable, is not noteworthy, not indicative of criminal designs. In this context, Goffman describes the role of "camouflage," "whereby an organism assimilates itself in appearance to the inanimate surrounding environment" as one of many strategies of "control moves" in "expression games" (1969, p. 17).

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[20]The popular distinction between "crime in the streets" and "crime in the suites" is indeed of consequence, at least in this respect.

Similarly, Moore describes the way in which heroin dealers attempt to hide the "signal" of their activities in the background "noise" of normal daily activities (1977, pp. 24-25). Heroin can be stored with mothers or girlfriends who are usually visited for legitimate purposes. It can be exchanged in a handshake, or the purchase of a beer or newspaper. As long as these licit daily activities usually do not accompany a drug transaction, they can be pursued to increase the amount of noise surrounding the dealer's illicit dealings.

> If a dealer wants to use his mother's apartment as a safe place to store heroin and he wants to be able to have ready access to it, he must become an extremely dutiful son. He must visit his mother on many occasions when he does not bring or take away heroin. Similarly, if a dealer wants to pass heroin on the street through casual encounters, handshakes, and embraces, he must spend a lot of time encountering, handshaking, and embracing when he is not exchanging heroin. In effect, the constant motion, interaction, and hustle that is typical of heroin dealers serves the same function as the incessant wiping, scratching, and arm crossing of major league baseball coaches: an observer attempting to figure out the sign is uncertain about which activity is the real sign (Moore 1977, p. 25).

Furthermore, dealers frequent areas of the city that are socially disorganized, in which the activities of their non-dealing occupants tend to resemble those typical of the heroin dealer: people "hanging out" on street corners, considerable movement and interaction. Dealers rely on these environments, then, to provide the additional background noise that they do not provide for themselves.

This concept of "noise" - that only one out of numerous identical acts are in fact related to an illegal scheme begins to highlight the problems of relying heavily on the institutions of privacy notion in assessing the vulnerabilities of illegal behaviors. Even if there were no institutions of privacy, even if all behavior were observable, there is so much noise in the behaviors observed

that it would be unlikely that genuine signals could be isolated from the background noise, even if observational resources were substantial.

Deviant behavior is so highly dispersed and infrequent, that it is simply unlikely that observers would be there to see it. A sense for the futility of this task is provided by some statistics on routine police patrol, whose efficacy is based on the assumption that patrolmen will encounter and observe illegal activities. Albert Reiss, in a study of several large urban police departments, has calculated that less than 1% of the time spent on routine preventive patrol yields a criminal incident worthy of attention (1971a, p. 96). The Crime Commission Science and Technology Task Force estimated that a Los Angeles patrolman could expect to detect a burglary once every three months and a robbery once every fourteen years (President's Commission 1967, p. 12). And, finally, we have learned from the 1972-73 Kansas City Preventive Patrol Experiment (Kelling et al. 1974) that crime (as measured by crime statistics and victimization surveys) did not increase in those sectors of the city in which preventive patrol was entirely eliminated, nor did it go down where the normal number of cars assigned to preventive patrol was doubled or tripled.[21]

Hence, the problem of observing illicit behavior is not simply one of breaking down institutions of privacy that conceal illegal conduct. The problem is also one of allocating observers across a large and highly dispersed social landscape, directing them to seek out very infrequent illicit behaviors that often may not look very different from their licit counterparts. As Reiss has argued, the use of proactive (read "observational") methods for detection are only viable for offenses that are somewhat predictable (1974, p. 683). The elements of offense predictability include the frequency of its occurrence, its

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[21]Of course, these data speak as well to the deterrent value of police cars patrolling city neighborhoods.

duration, and the degree to which the activities are organized (Reiss 1974, p. 683). Offenses that are both predictable and occur in public places, then, are most vulnerable to observation. Thus, for example, because moving vehicle violations occur in public places and with so much frequency, it is likely that a sufficient number of such offenses will be observable to police surveillance (Reiss 1974, p. 683).

Reiss also suggests that offenses that are more socially organized are more vulnerable to proactive policing, particularly where offenders do not attempt to subvert police detection through corruption or cover-up. Thus, "activity organized around an economic market, such as the illegal manufacture and sale of alcohol and narcotics or the service of prostitutes, and around the socially organized exchanges in 'victimless crimes'" (Reiss 1974, p. 683) are more vulnerable to police observation. In a similar vein, Sherman found that massive highly organized police corruption arrangements are more predictable than solo ventures or those involving fewer people (because, in the former case, any of several individuals can be subject to surveillance) and are therefore more vulnerable to detection (1978, p. 43).

Temporal features of offenses are also related to the predictability, and hence vulnerability, of the offense to detection through observation. Reiss differentiates offenses into those of very short duration, those which are episodic (for example, acts of solicitation or buying or selling contraband), and those which "continue for a considerable period of time, usually until action is taken to remove the violation" (such as embezzlement, expiration of a driver's license, fraudulent reporting of income (1974, p. 683). Offenses that continue over time are more vulnerable to observation than those of short duration because the time frame during which events are observable is appreciably extended. Crime episodes are also less immune to observation

because their episodic patterning can be detected by surveillance.

Lawrence Sherman, in his study of the control of police corruption, found it necessary to expand Reiss's distinction of crime episodes. Sherman differentiates between "events" and "arrangements." Corruption events involve unique one-time combinations of individuals, for example, when a speeding motorist pays a bribe to a cop. Events are at most repetitive. Corruption arrangements are duplicative corruption events. They do not involve unique one-time combinations of individuals. The same officers accept bribes from the same parties month after month, perhaps for their entire careers (pp. 42-43). Because corruption arrangements are duplicative, they are more predictable and thus more vulnerable to observation. Sherman continues his argument by asserting that those corruption events with the most "duplicative" links are most vulnerable to surveillance. For example, the theft of money by police from arrested drunks was a common problem in one of the police departments that Sherman studied. Since the "rolled" drunks were different, they were parties to corruption "events." But, since the location in which they were rolled (jail) was always the same and the officers were always the same, it was possible to send actors under cover, posing as drunks to see whether their money would be taken. In contrast, it was more difficult to monitor corruption in the form of officer thefts from drug pushers. For now, not only were the "victims" in each event different, but so was the location. The only duplicative link was the corrupt officer (Sherman 1978, p. 44).

Indeed the predictability of the social location of corrupt acts is an important one for Sherman. Since police work is by necessity so dispersed, decentralized, and unsupervised, the opportunities for monitoring are appreciably reduced. Sherman's contrast between the control of police misconduct and that of bank tellers (who work in fixed locations in full public

view with regularized accounting procedures) through surveillance is quite compelling (1976, p. 19). His discussion of patterns of police corruption employs a combination of concern for temporal elements of the offense, offense participants, and social location, and his distinctions pertain to the amount of predictability implicit in the variability in behavior on each dimension.

As social scientists turn their attention more systematically to the study of white collar crimes, more refined conceptions and distinctions pertaining to offense duration, its location and organization will have to be developed. It is one thing to attempt to differentiate the sequence and frequency of discrete bribe payments. It is quite another to characterize a fraudulent securities scheme of several years duration in which thousands of victims are individually and collectively solicited to invest funds over a period of months, in which misleading reports and prospectuses are released on several occasions, in which insiders occasionally misappropriate corporate funds, and in which a constantly changing staff of offenders, holding positions in an elaborate division of labor, participate in both licit and illicit activities. The problem of characterizing such an offense is a topic of discussion in the substance of the dissertation. As a preliminary statement, I would suggest that as offenses become organizationally complex, as they involve multiple offenders and victims and multiple victimizing transactions, and as they extend over time and social and geographic space, their vulnerability through observable behavior (as well as through diffused information) is increased.

The Residue of Illegal Activities

Finally, illegal activities are vulnerable to detection because of the "residue"[22] they leave. This label, though a bit unusual, is inspired by the

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[22]The term "residue" is consonant with that of "artifact" used earlier in the chapter.

marvelous and creative cover-up activities of the notorious price-fixers in the heavy electrical equipment industries, one element of which was to save all waste-paper generated by their illicit price-fixing meetings to be destroyed personally (Smith 1961, Geis 1967). Even the waste generated by these meetings, if examined, might have been indicative of the substance of these meetings. Other residue of the price-fixers that they carefully guarded: the attendance roster of the colluders in the price-fixing negotiations - labeled the "Christmas card list;" notifications of meetings - sent in plain envelopes and dubbed "choir practice;" the expense account entries for travel to and from meetings that could establish that colluders were in the same cities on the same dates - phony vouchers were provided for different cities and different dates;[23] long-distance telephone records - calls were made on public telephones.

Many illegal activities do leave "residues." Drug addicts accumulate track marks. Some adolescent women "victimized" by statutory rape get pregnant. Many traditional crimes leave physical evidence: dead bodies, bruises, broken bones, gun shot wounds, broken windows, jimmied doors, the contents of drawers spread across a room, burning buildings. Included among the kinds of physical evidence which are typically analyzed in criminalistics work are: blood, semen, and saliva; documents; drugs; explosives; fibers; fingerprints; firearms and ammunition; glass; hair; impressions; organs and physiological fluids; paint, petroleum products; powder residues; serial numbers; soils and minerals; tool marks; and wood and other vegetative matter (Saferstein 1977, pp. 22-23).

In some cases, secret behavior is not observable, but related aspects are observable. Erving Goffman (1969, p. 25) describes Theodore Sorensen's (1965, p. 63) account of the Cuban Missle Crisis during the Kennedy administration. In

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[23]It is of some interest that although some price-fixers filed false travel vouchers, they never asked for expense money to places more distant than the city they actually visited (Geis 1967).

order to forestall suspicions of crisis, members of the National Security Council coming together to meet on the crisis, arrived at the White House at different times and entered through different doors. Like the electrical price-fixers, members of the National Security Council attempted to conceal the simultaneity of their association lest inferences be made about their secret behavior.

These kinds of physical or behavioral evidence do not directly display the salient secret or illegal behavior; rather they reflect the residue of that behavior - changes in physical commodities or patterns of movement - that can be examined to make inferences about the behaviors which generated it.

The residue of most kinds of white collar crimes tend to be in the form of records. The vulnerability of such records is highlighted in some of the most common elements of the cover-up jargon: "slush funds," "laundering money," "deep-sixing," "never see the light of day," "the 18-minute gap." Because many white collar crimes are continuing offenses, involve financial transactions, and rely on the use of written or recorded materials to facilitate these illicit transactions, voluminous records and forms of data are most always generated. Records may simply be non-essential artifacts of illegal activity, for example, long-distance telephone charges, which might establish interactions, credit card receipts for hotels, air fare or gasoline which might establish the location and movement of offenders, or bank records which might establish the timing and magnitude of monetary transactions. Other records are the substance of the illegality itself - receipts, certificates, orders, contracts, documents, memoranda, checks, bookkeeping entries, etc. Although these records, in and of themselves, rarely disclose illegal behaviors (in Katz's (1979b) language: "presumptive evidence" of crime), they may nonetheless be indicative of potentially illicit behavior.

That records are an important component of the law enforcement process is underscored by many of the most common cover-up strategies surrounding white-collar crimes: destroying records, doctoring records, creating phony records, generating new or supplemental records, maintaining two or more sets of books, creating and utilizing slush funds, failing to keep records, bypassing recordkeeping systems (i.e. using cash rather than checks), or use of computer software to create, maintain, and manipulate records to conceal certain transactions or to create a façade of normalcy.[24]

In most cases of traditional or white collar crime, offense residues may be useful in the investigation of an already detected offense, in the creation of circumstantial evidence, but will not be central to detection efforts. For many traditional crimes, victims and witnesses are available to observe the illegal behavior itself. The records that suggest white collar crimes are often private and therefore only accessible after suspicions have developed and investigators request subpeona-like powers. But, for some offenses, where records and residues are public and where the offenses themselves are not observable and disclosures by participants are not forthcoming, residues may be the only means by which violations will be detected.

The Relationship Between Detection and Behavior

It should be fairly obvious by now that strategies of detection are related to the social organization of deviant behavior and its vulnerabilities. Behaviors are vulnerable only if outside parties or institutions are organized to respond to these vulnerabilities. If incentives are not provided for

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[24] In the Equity Funding insurance fraud, offenders were able to conceal their activities (creating phony insurance policies) from state auditors by programming the computer to stay a few steps ahead of the auditors, shifting accounts from file to file, so that those considered by the auditors were always flawless and genuine.

disclosures, for example, it is unlikely that many disclosures of useful intelligence will be made. It may be that all groups of numerous participants have inherent tensions of disintegration and individual disloyalty. But this vulnerability and the possibility of insider disclosures cannot be exploited unless external systems stand ready with threats of severe punishment against all participants and assurances of leniency to the first to squeal. The necessity of the prostitute to solicit customers in public places does not leave her vulnerable if social control agents neither engage in surveillance nor send out officers as undercover "Johns" to be themselves solicted. And the executors of bribery schemes need not create slush funds and conduct business off the books if their records are never scrutinized or audited. It is the nature and organization of intelligence systems, then, which create vulnerabilities in patterns of behavior.

Of course, this relationship is not a static one. As offenders learn of the vulnerabilities in their behavior and of the details of the intelligence process in which they may be entrapped, they reengineer, retool their activities to minimize these vulnerabilities. In earlier discussion, many of these protective strategies orchestrated by offenders were described: Offenders who go to the trouble to "cool-out" their victims or to discipline their customers for unauthorized disclosures; corporate executives who develop complex record keeping systems to conceal irregularities or who conduct activities off the books; subversive or criminal organizations which contrive an elaborate organizational structure which masks the identities of major participants and which buffers them from interactions with outsiders; and so on. Similarly, agencies retool and redesign their intelligence strategies as they gather better information about the organization of behavior they wish to detect and about the cover-up obstacles that may be placed in their path.

The major purpose of this dissertation is to exemplify this relationship between the organizations of both behavior and intelligence. But it is also to explore the obvious but rarely considered truth - that the social organization of intelligence constrains the type and quality of information it uncovers. Of greatest concern in this monograph is the correlation between intelligence systems and the patterns of behavior that they uncover. What kinds of offenses are detected by what kinds of detection methods? Are there certain types of offenses that are typically uncovered in only a single way, and other types of offenses that are detected in various ways? Are some detection methods more "multi-purpose" in their output of offenses than others? Furthermore, are there characteristics of the execution of the offense, apart from the kind of offense that it is, that are related to the way in which it is detected?

But the output of intelligence can be evaluated with regard to characteristics other than the nature and pattern of the behaviors that are detected. At the beginning of the chapter, the concern for intelligence failures in the organizational intelligence literature was noted. Intelligence failures cannot be easily evaluated where the process is concerned with detection, since, by definition, the failures are all the offenses which we know nothing about. But we can consider aspects of the quality of detection strategies. How accurate is the information they uncover in light of subsequent investigative findings? How recent or stale is the information which they uncover?

The first question concerning accuracy pertains to the informal hypothesis suggested earlier, that detection methods have differential access to behavioral information. And access is related to accuracy. Access was considered on two dimensions: (1) the actual media of information - are they first-hand observations, second-hand disclosures, or artifacts which suggest inferences

rather than direct knowledge? and (2) the social location of the source of intelligence - does information issue from actors directly involved in illegal activities or from those somewhat more removed (such as colluders, contributors, victims, or parties proximate to but uninvolved in any aspect of the offense)? As suggested earlier, are artifacts in fact more inaccurate than observations? Are victim disclosures more inacccurate than those by participants? Finally, one might consider the impact of the incentive structure on the accuracy of information emanating from particular sources.

The second dimension of the quality of detection strategies concerns temporal considerations. What is the relationship between the timing of an offense and the timing of its detection? Borrowing some ideas suggested by Albert Reiss, Lawrence Sherman developed the distinction between the premonitory and postmonitory control of police corruption (1978). A premonitory detection system is one in which intelligence is gathered prior to or during the execution of an offense, postmonitory systems after the offense has already occurred (1978, p. 20).

From the perspective of many white collar offenses with which I am concerned, this distinction should probably be further refined to correspond to the temporal subtleties of many offenses of this kind. First, many white collar offenses are of considerable duration. Therefore, it would be useful to differentiate premonitory methods to reflect the amount of elapsed time in the offense rather than only the fact that the offense is still ongoing. Secondly, many white collar offenses are not single discrete behaviors. As a result, it is difficult to define offense conclusion. Reiss noted that some activities like the failure to renew a driver's license continue indefinitely until some remedial action is taken (1974, p. 683). For other offenses, a criminal organization has engaged in activities and is mobilized to continue them. For

example, disclosures by a particular victim who paid money into a Ponzi scheme may be postmonitory. But this disclosure may be premonitory with respect to the other victims who are still being recruited. Hence, for many white collar offenses, it may be more useful to consider how long they have elapsed rather than whether or not they have ended.

Nonetheless, the notion that detection methods may vary in the temporal characteristics of offenses they uncover is an important one. Types of offense vulnerabilities are found at different points in the sequence of an offense. For example, vulnerabilities associated with the need of offenders to publicly recruit clientele generally occur early in the execution of an offense. Vulnerabilities associated with disclosures by victims ususally come much later. Presumably, the likelihood of disclosures by participants should increase over time, given greater opportunities for inadvertent leaks or for conflict and disloyalty among members. Given differences in the timing of offense vulnerabilities, one would expect differences by detection method in the age or staleness of offenses they uncover. If true, this hypothesis has significant policy implications. Those detection methods that intervene earliest in the sequence of ongoing offenses would be of greatest value to social control systems that seek to forestall the execution or to minimize the impact of illegal activity.

The Research Setting

The data with which these ideas will be given empirical expression pertain to violations of the federal securities laws and their control by the United States Securities and Exchange Commission over the past half century. It should be no surprise to the reader that I find the complexities and subtleties of white collar offenses not only fascinating, but theoretically important as well. In opening the chapter, I argued that it was indeed unfortunate that

sociologists, who know so much about the collection of data on human behavior have so little to say about this enterprise in other organizational contexts. It is also unfortunate that sociologists who know so much about social interaction, organizations and supra-individual phenomena, spend so much of their time studying the deviant behavior of the individual, whose contact with others in the execution of his or her offense is nonexistent or evanescent at best. To both paraphrase and contradict George Homans, it is time to bring organizations back in.[25] The study of white collar offenses and their control allows us to do so.[26]

The Securities and Exchange Commission is a superb setting for exploring the issues introduced in this chapter. It provides a setting in which most of the tremendous range in the organization of both illegality and intelligence can be found. Because of its broad jurisdiction over offenses and offenders, its enforcement work includes considerable diversity of targets of investigation. They include offenses by huge corporations listed on stock exchanges and tiny newly emerging businesses that generate their first capital through fraudulent representations to purchasers of their securities. One finds offenses by persons and by organizations, of long and short duration, of vast and narrow geographic scope, of brillant, subtle, and carefully concealed wrong-doing and of obvious, blatant designs which take in only the most gullible, of witting and unwitting victims and of no victims at all. The detection strategies utilized by the SEC cover almost the whole range of those introduced earlier, with the possible exception of undercover work and participant observation. And the agency presents an enforcement history that has consistently won praise as being

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[25] In his Presidential address to the American Sociological Association, Homans (1964) argued that it was time to bring men back into sociological analysis, to focus on individual rather than organizational explanations of phenomena.

[26] For a discussion of the roles of organizations in crime, see Shapiro (1980).

tough, innovative, and uncorrupted (Ratner 1971, 1978, Miller 1979b, Subcommittee 1976).

In short, the nature of SEC work brings together a whole panorama of phenomena of relevance to the theoretical work developed here. But a study of the SEC has perhaps an even more important theoretical virtue. All of this variability is contained within a single regulatory agency. Earlier in this chapter, James Q. Wilson's interesting discussion of investigators in the FBI and Drug Enforcement Administration were contrasted. Wilson attempted to argue that the very peculiar problems of mounting an enforcement program directed at the control of drugs occasions some very peculiar investigatory strategies. Wilson supports this argument with his ethnography of the very different patterns in the work of FBI agents and that of DEA agents. But, although the argument seems plausible enough, there is always a compelling alternative explanation in the background that cannot be dismissed: FBI agents and DEA agents do different things because the FBI and the DEA are different. By centering this dissertation solely within the SEC, such organizational explanations can be dismissed, and we are able to systematically explore whether differences in offenses are indeed correlated with detection strategies. But because the SEC is such a rich setting of research, little is lost by focussing on a single agency.

Although I praised the complexity and richness of exploring white collar crime earlier, it has one drawback. Its complexity makes the task of acclimating and educating the reader much more difficult. And since this research deals with a regulatory agency rather than the police or FBI or more familiar social control agencies, I must assume that the reader needs a more lengthy introduction to the SEC and its work. This dissertation is therefore divided into two parts: (1) a three chapter introduction to the details of this

research (Chapter 2), to the history and organization of the SEC and its enforcement program (Chapter 3), and to the nature of securities violations, violators, and victims (Chapter 4); and (2) an analysis of the questions posed in this chapter with reference to the enforcement work of the SEC and the offenses over which it has jurisdiction (Chapters 5 - 8).

CHAPTER 2: THE RESEARCH: DESIGN, METHOD, AND EXECUTION

The typical dissertation methods chapter tends to be a tedious aside, a ritualized distraction from the flow of its exposition. Its purpose is to demonstrate competence if not sophistication of the writer as researcher and to engender trust in the data by his or her readership. Futhermore, it runs through a variety of criteria and establishes a set of parameters around which subsequent data analysis can be evaluated. My aim is not to denigrate these purposes or argue against the need to establish trust or to describe these basic parameters. Rather, it is to suggest that the methods section be, not an aside, but rather an integral part of the dissertation; that it make a contribution to its readership as significant and substantive as the rest of the manuscript from which it ususally distracts.

This "philosophy" is particularly appropriate in the case of this dissertation, in that, in many respects, the design and execution of the research was more difficult, challenging, and time consuming than the analysis of its findings. Furthermore, execution of the research provided the writer with an assortment of experiences unique for a graduate student or even for a more seasoned academic researcher - experiences related to securing access to sensitive, non-public records, hearings, deliberations, and meetings, of establishing a meaningful research relationship with a federal bureaucracy unaccustomed to such an association, of balancing the dynamic richness but limited vision of observational research with the static exhaustiveness and limited vision of archival research, and of bridging the intellectual chasm between practicing lawyers and academic social scientists. To exclude these insights because they have no place in the standard methods chapter formula would be a disservice to the reader, particularly given the dearth of empirical

inquiry into white collar crime and its regulation, and hence the difficulty of gleaning them from other sources. Indeed, I suspect that these experiences may be of wider interest and value than the research findings that they generated. That suspicion, in part, motivates the orientation of this chapter. Of course, an exposition of method to the exclusion of consideration of data and explanation is ill-placed. Indeed, evaluation of the quality and value of the experiences must be based upon the quality and value of the data they generated.

In short, the orientation and style of this chapter is to share with the reader a series of experiences, decisions, and outcomes that are instructive and engaging rather than distracting. The experiences are not recounted in story book fashion or with any narrative logic. However, they are implicit in the series of topics considered in the chapter, concerning access, data collection, the research population, sampling, coding, and particular attention to variables pertaining to the source of investigation. As the chapter unfolds, it becomes increasingly stereotypic and attentive to ritualized concerns, but hopefully its spirit, if not its message, distinguishes the chapter from its traditional counterparts. Those readers who simply want to learn about research execution and are willing to trust the methods sight unseen are advised to concentrate on early sections of the chapter.

As introduced in Chapter One, this dissertation is about the process by which organizations secure intelligence about events in their external environment. One of the more useful analogies to this intelligence process considered in the chapter was that of social science research. Some of the same concerns about data quality, reactivity, units of analysis, and scope of perspective, deemed central to the intelligence activities of social control agencies, are also central to research design. In undertaking the SEC research, it was necessary to make decisions about intelligence strategy, and to

anticipate and evaluate the consequences of selecting one strategy over another. In the early pages of this chapter, this process is described.

Access to the Research Setting

The research upon which the dissertation is based reflects my developing interests in the study of the social control of white collar crime at a time when, coincidentally, officials of the United States Securities and Exchange Commission (SEC) were visiting the Yale Law School where this research was being supported. At that time both the Chairman and the Director of the Enforcement Division of the SEC participated in a special program on international bribery. Subsequently, the Chairman served as a visiting scholar at the Law School, and the Director of the Division of Enforcement as a guest lecturer and as a participant in an advisory conference on white collar crime. Contacts and conversations with these officials suggested that the SEC would provide a fascinating setting for research on white collar crime and indicated the receptivity of these officials to the execution of research of this kind.

These conversations began in early spring, 1976. I was invited to visit the Headquarters Office of the agency over the following summer to observe its operations and learn more about the enforcement of the securities laws. Despite this invitation for an observation period over the summer, the research on which the dissertation is based, and which required a second grant of access, did not begin until late spring, 1977, when full access and bureaucratic cooperation were finally extended. The long wait was not a function of bureaucratic delay and red tape. Rather, it reflected very serious consideration by SEC officials of whether the research should be permitted, and included more than one juncture where the possibility of any research at all seemed especially bleak. However, this very long year was not consumed by idle patient waiting. By very conservative estimates, efforts related to securing access included the drafting

of three separate research proposals, about a dozen letters, more than a half dozen meetings, at least twenty-five phone calls, at least three trips to Washington, and about four months of daily visits to the SEC (to conduct research primarily, but also to negotiate access). These efforts do not reflect contacts and communications involved in the definition and evaluation of realistic research possibilities; they reflect purely access-related communications.

In the course of this year long effort, at least a half dozen persons from Yale with professorial and high administrative positions participated in negotiations with at least twice that number at the SEC, including directors and their associates in offices of the Chairman, Executive Director, Division of Enforcement, General Counsel, and Data Processing. I was clearly dazzled and outranked by the prestige and position of the parties arrayed in negotiations responding to this request for access. Indeed, it is unlikely that a person of my stature could have alone secured access and equally unlikely that an SEC employee of my status could have extended it.

This assumption derives from the fact that the request for access of this kind was unprecidented and the implications serious enough to require the involvement of high-level SEC officials. The agency had considerable experience with requests by outsiders for information. These have issued from the varied participants in securities transactions, the securites bar, the media, and others. The agency also had some experience with in-house research as well as with the commission of outside consultants to provide resources to the agency. There were precedents as well for summer internships for law students, a status not extremely unlike that extended to me in the summer of 1976, and undoubtedly the bureaucratic precedent that made such an invitation possible. But there was no experience or precedent for requests of this kind from academic

researchers.[1] The role of academic researcher apparently slipped through the stools between consultant, journalist, and student in the judgement of SEC officials, and it was unclear how to respond to a request from such a source. This ambiguity and absence of precedent, on the one hand, and fear of the precedent that any positive response to the requests might have, on the other hand, resulted in the activation of the agency "big guns" in a matter of otherwise minor proportions.

The matters involved in negotiation were varied, though much of the process simply involved charting the waters, introducing officials to the academic research role and the integrity, ethics, and controls upon that role that can be expected. Substantive issues involved concern for violations of privacy or confidentiality, the disclosure or collection of identifying information or of details of enforcement policy or strategy, and the implications of this grant of access on requests by others under the Freedom of Information Act or other vehicles. The conditions of the compromise that ultimately led to the granting of access were that only closed investigations would be scrutinized, both direct or indirect identifying information concerning parties under investigation would not be recorded, and all writings based on the research would be submitted for prior clearance to the General Counsel to guard against disclosure of non-public, confidential, or of identifying information.

The terms of compromise have generated some costs. Clearance procedures are slow and burdensome and somewhat intimidating. Were it possible to record

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[1]The interesting issue raised by the invitation is that in the student/observer role, I was offered easy access to much more sensitive and private matters than anything requested in the proposal for systematic research. Presumably in a student role I was innocuous. Students simply get socialized, have experiences, and store them in some region of the brain. Emanating from a professional role, however, with the expectation that experiences (even though less private or secret) would be recorded and widely disseminated, my request was considerably more threatening, or at least responded to in that way.

identifying information, if only temporarily, the quality of some of the data would have been significantly improved. This condition limited research to materials included in archival records and precluded gathering supplementary data from other sources which are stored by these deleted identifiers. For example, it would have been clearly useful to have information about the size and business operations of an organization investigated by the SEC, rarely available in any detail in investigatory records. In many cases that information is readily available in SEC filings, other directories of registered professionals or securities issuers, and other business directories. These resources, however, could not be tapped because of this compromise.

By far the most substantial cost, however, was imposed by limitation of the research to closed cases.[2] As a result, the research does not reflect the last few years of agency practice, a period that has witnessed dramatic change in and increased public attention to the Enforcement Division of the SEC. Besides precluding a fascinating analysis of organizational change, this restriction on access has generated the research product of considerably less value even to the SEC itself, because of its inability to examine or provide data on contemporary issues.

Sources of Data and Data Collection Strategies

As noted in the previous section, the research was conducted in two phases, each with separate problems of access. The first phase, conducted for about six weeks during the summer of 1976, involved observation of the Headquarters and one of the regional offices of the SEC. The second phase, conducted for about nine months from the spring of 1977 until the following winter, involved the examination and coding of archival records. Each phase will be described in

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[2]The section on "Sampling" later in this chapter provides greater detail on the methodological implications of a restriction to closed cases.

turn as will the reasons for the transition in data collection strategies employed in each phase.

Observation Strategies

During the period of observation, I was affiliated with the Division of Enforcement in the Headquarters Office of the SEC in Washington, D.C. Like regular SEC employees, I was bound by sworn statements pertaining to disclosure of information, protection of privacy, conflict of interest, and the like. I was therefore permitted access to the meetings, conversations, documents, and miscellaneous information readily available to regular staff. I spent most of my time with a section of the Division concerned particularly with management fraud - bribery, corruption, and self-dealing - by corporations registered with the agency as stock issuers. However, as a matter of physical location, I floated through the Division, occupying desks or offices temporarily vacant when attorneys were out of the office or vacationing. This considerable mobility provided quite a broad perspective and the opportunity to learn by observation and informal conversation what might otherwise have required formal interviews were my physical location more fixed. The sudden intimacy imposed by sharing a tiny office with someone for a day or two naturally generated "small talk" as well as informal conversations and opportunities for observation that provided rich and colorful detail about the nature of his or her work.

Daily activities were varied. Perhaps most frequently, I engaged in formal and informal interviews and conversations with SEC staff in various positions in the agency. These included Commissioners and their law clerks, officials in the Chairman's and Executive Office, directors and branch chiefs in the Enforcement Division, Enforcement Division attorneys, administrative personnel, secretaries, consultants to the SEC, former SEC attorneys, SEC research economists, assorted staff in other divisions, and officials of other government agencies concerned

with some aspect of securities law enforcement. I became a voracious reader. Whenever there was an interactional lull, I would read whatever I could get my hands on - documents, reports, memos, releases, instructional materials - provided by staff members with whom I had spoken. I scoured the SEC library for materials unavailable elsewhere.

I sat in on daily meetings of the Commissioners with their staff, the most common concern of which was the consideration of enforcement matters of the Headquarters and all regional offices. The authorization of Formal Orders of Investigation (which provide subpoena-like power for SEC staff conducting an investigation), for the institution of any enforcement proceeding (civil, administrative, or criminal referral), and for any settlements that may emanate from these proceedings must first be obtained from the SEC Commissioners. These daily meetings provide the forum for requests for such authorization and their evaluation. Requests are rarely rubber-stamped; they often generate heated debate and extremely close scrutiny of particular matters. These meetings, which usually lasted several hours every day, provided an excellent opportunity to learn about the enforcement problems of greatest contemporary concern to the agency, about agency organization and decision-making, and about the development of enforcement policy. Although I was afforded the opportunity to attend these very private Commission meetings, opportunities to participate in smaller less formal meetings were uncommon. I was included in few meetings between staff attorneys and was never invited to participate in those which included outsiders (subjects of investigation or their attorneys, witnesses, etc.). In some sense, I was given both binoculars and blinders.

Early in the period of observation, I attended an annual week-long Securities Enforcement Training Conference, conducted by the SEC, in which about a hundred persons attended formal sessions concerned with everything from recent

amendments of the securities laws and current enforcement problems to techniques in obtaining testimony from witnesses to strategies for discovering evidence. Participants were primarily new SEC enforcement attorneys from the Headquarters and regional offices, but also included representatives of state and foreign securities agencies and of federal agencies concerned with related forms of white collar crime. Later in the summer, I was also able to visit one of the regional offices of the SEC for about a week. Because of this limited amount of time, interactions tended to be pre-arranged, and structured interviews more necessary than in the Headquarters Office. However, regional office staff were considerably more open, trusting, and informative than their counterparts in the Headquarters, and a considerable amount of information was amassed in a relatively short period of time.

This matter of openness of various persons and offices in the agency requires further discussion. The initial reactions to my presence in the agency were varied, ranging from openness, candor, and cooperation to disinterest to suspicion and paranoia. By far, the most common reaction was one of distrust. Late on the first day of my observational research, I was waiting outside an office for a pre-arranged appointment delayed by a last-minute meeting of several enforcement attorneys. Suddenly, one of them lurched to the door and slammed it in my face. There were quick apologies and the explanation that the attorney had thought I was an "outsider" (i.e. subject of investigation, defense attorney, journalist, etc.). This perhaps extreme and graphic example of the cloud of suspicion that hovered over me in those early days was more subtly evidenced in many other interactions. There was reticence by certain staff in answering my questions. Often when I was given in-house documents to examine, the party who had made them available would "drop by" to see "how I was doing" once or twice. In one instance, an attorney whom I had never met learned via

the grapevine about the fact and content of a conversation I had (which apparently had caused a stir) with a person in a different division in an office four floors away from his own - within fifteen minutes of the original conversation.

These early interactions with staff were not exclusively governed by suspicion and distrust, however. Several staff members, from the first interaction, were open, candid, helpful, and interested in my research. Some seemed flattered by my genuine interest in the most basic aspects and minor details of their experience. Some seemed to appreciate the opportunity to move beyond the particularistic details of their work and pull together common themes, insights, characterizations, or perhaps the personal outrage developing from their experiences. Some, in fact, sought me out for conversations of this kind. Others were less eager, but were genuinely helpful when solicited. There were no clear hierarchical or role related factors associated with paranoid versus open responses. The latter, however, tended to include persons who were more academically oriented, younger, and more often female. With time, I learned that formal introductions instituted by one of the members of the latter group substantially lessened the likelihood of suspicion or distrust in subsequent interactions with parties to whom I had been introduced. Regardless of the quality of initial interactions, as time passed, as I was introduced around, as I became a fixture in the office and easily recognizable as an insider, and as my interests and orientations were characterized as innocuous and unthreatening, the paranoia gave way to openness, candor, and in some instances, almost comradery.

The quality and quantity of data available from observational strategies were seriously affected only temporarily by problems of suspicion and distrust. However, after six weeks of working at expanding and perfecting these "methods,"

several other impediments to systematic research remained. These derive largely from the nature of enforcement work and the amenability of aspects of this work to observation. In general, many aspects of enforcement work are invisible, at least to the scrutiny of a single observer confined physically and temporally. They may be invisible for reasons implied previously - because I was denied access to meetings or conversations in which investigation was conducted or strategy discussed. Invisibility may derive from related factors - telephone conversations I could not hear, written correspondence or documents I was not shown, out-of-town or out-of-the-office field investigations which I did not join.

Invisibility may derive from the fact that there is nothing to see. Typically, SEC investigations are protracted over a period of years. There may be weeks of intense investigation and then the matter may sit on a back burner for months. Where investigation is intense, there may be several simultaneous activities warranting observation; where it is not, there may be nothing to observe. Because of the complexity of cases and their extended life, investigatory responsibility may be diffused and delegated among many staff members because of matters of expertise and personnel turn-over. It may be difficult to reconstruct the process without observing or interviewing all these parties. For the same reason, specific enforcement activities may become particularized. A two hour Commission meeting may involve the consideration of the sanctioning of only one participant in a massive securities fraud. The sanctioning of other participants may have been discussed previously. But without knowledge of these prior discussions, the particular observation is quite out of context and subject to considerable misinterpretation. Finally, because the conduct of investigation and prosecution consumes so much time, their turn-over is relatively slow. Observational strategies, then, do not

permit the accumulation of a very large base of data. Both the quantity and, in many respects, the quality of data so obtained are limited.

Observational strategies in this context are suited to the development of a rich ethnography of the typical elements of enforcement experience. They facilitate the exploration of the organizational structure of the Commission and Division of Enforcement and permit an exploration of the occupational roles allocated to enforcement work. In short, one can study in detail the day-to-day activities that somehow are aggregated and result in the enforcement of the securities laws.

What observational strategies obscure, however, is a sense for the continuity of activity or for the formula of aggregation. Despite the length of the period of observation, in this context observational methods are almost necessarily cross-sectional. This derives from the protracted period of the development of investigation and the simultaneity of investigative activities. One is prohibited from contrasting developmental processes. Instead one contrasts series of "snapshots" taken at various points in different developmental sequences. These snapshots are clear and detailed, but a viewing of the films from which these stills were taken is also needed, to see how they began and how they ended, to see whether similar stills came from similar films, and to understand why dissimilar snapshots differ. The films lack the detail of the blown-up still shots, and, because they take longer to view, they are accorded a greater superficiality of observation. But they serve as a useful corrective to the lack of continuity inherent in observational methods. For this reason, I sought some data base that captured the diversity of enforcement activities, but which afforded the distance to appreciate their continuity, if only retrospectively. This is reflected in the archival phase of the research and the choice of the investigative record as the window through which

enforcement activity would be viewed.

The Examination of Archival Materials

The second phase of research, and that from which most of the dissertation data are derived, involved the examination of investigatory records. This portion of the research served as a corrective for some of the problems inherent in the observational research noted above. Since materials were accumulated by case, it was possible to monitor all aspects of an investigation over time and the involvement of different staff in its conduct, as these activities were documented and retained in the records. Since all investigations were completed, it was possible to follow them from beginning to end. The reliance on records permitted access to events that might have occurred simultaneously or that might not have been otherwise observable. And, of course, the reliance on records maximized one's use of time - a larger quantity of activities could be monitored retrospectively than would have been possible if one had to wait for them to unfold.

This form of data collection, then, provided a sense for the continuity of events and permitted a larger sweep of "observation" than was possible through direct observation. Obviously it had its costs: in superficiality of recorded information and in the absence of the rich detail of activity that is never recorded. Furthermore, the whole is not equal to the sum of its parts. One cannot cumulate investigative cases and in any way reconstruct a sense for the social organization of enforcement activity. Archival and observational methods, then, complement each other nicely. They elaborate the whole and the parts, the static and the dynamic. Together they paint a rich and comprehensible portrait. Unfortunately, in this research, the observational and archival methods focused on different times and locations in agency experience. The composition is imperfect, but the insights are nonetheless valuable.

The choice of the formal investigation as the organizing device around which a dynamic perspective on enforcement activity would be constructed came easily, since it serves as primary device by SEC staff for organizing their own enforcement work. The fact that the investigation is but one way of viewing or organizing enforcement work was perhaps not appreciated as clearly as it should have been. The implications of this choice of perspective are considered in the section on the research population.

Although, during this second period of research, I was concerned primarily with the collection and coding of archival materials, informal observation continued and a few more structured interviews were conducted as well. Since it was necessary to examine all archival materials on SEC premises, the possibility of implementing observational research strategies was always available. Unfortunately, the work with investigatory records was conducted in a second building which houses most of the SEC clerical and "blue-collar" staff located about a mile away from the main SEC building which houses the Commission and Enforcement Division, the subjects of previous observation. Hence, it was necessary to make a special trip to the other building to interact with these parties. And since I was no longer a daily fixture with desk space in this social world, the kind of informal interactions described above were now more difficult and contrived.

Nonetheless, my new location was not devoid of observational opportunities. As students of organizations have taught us for years, the "underclass" of organizations are valuable informants of organizational functioning, and those of the SEC are no exception. Their gossip, conversations, characterizations of their work, characterizations of the agency and its changes over the many years of their employment had the candor and richness often absent in my interactions with their counterparts in the agency "upperclass." This last observation is

critical. These lower level employees tended to have much longer tenure with the agency than the attorneys, division heads, and administrators, and therefore were much better informants of agency history, particularly of concrete changes in policy and job descriptions.

The investigative file. Files which gather the materials generated by all SEC docketed investigations since its creation in 1934 have been saved and are stored in the Federal Records Center in Maryland. Files range in size from several pages to dozens of boxes and thousands of pages. The average file in the sample had perhaps several hundred pages. The size of a file is usually correlated with the scope of investigation and the fact of and nature of formal prosecution. Some files, regardless of age, seem more complete than others, but the vast majority share a richness of detail that is both gratifying and overwhelming to the researcher. Among the items typically found in an investigatory file are:

(1) forms completed upon opening and closing the investigation, noting the circumstances of the investigation, the acts and statutes allegedly violated, dates, identities of investigators and of subjects investigated, the nature of the illegality, the type and outcome of prosecution, if any, and justifications for prosecutorial choice;

(2) quarterly reports noting the progress of investigation;

(3) memoranda to the Commission requesting Formal Orders of Investigation or the institution of civil, administrative, and/or criminal proceedings, generally describing the offense and offenders in great detail and outlining relevant considerations and precedents for taking the action requested;

(4) other memoranda between staff;

(5) copies of correspondence to and from the agency pertaining to offenders, victims, informants, other social control agencies;

(6) criminal reference reports transmitted to the Department of Justice requesting criminal prosecution, prepared with great detail to the nature of the offense, the investigation,

available evidence, prosecutorial rationale, etc.;

(7) copies of civil complaints, indictments, administrative charges and announcements of the outcome of proceedings;

(8) press and other releases, newspaper articles and clippings;

(9) records of file searches for "recidivism" information on the subjects of investigation;

(10) reports prepared for probation or pre-sentence investigations;

(11) transcripts of testimony, documents, records, copies of subpoenas, court exhibits and papers.

Usually all of the items listed above were routinely examined save item number 11, the records of which tended to be massive and difficult to make sense of. However, even these materials were scrutinized where files were incomplete or available information confusing.

Investigative files simply accumulated all of the materials generated by an investigation. They were not prepared for some purpose other than storage, nor were they organized for presentation to some audience other than those attorneys conducting the investigation. Files contained scratch paper, notes, rough drafts of memos arrayed among the more formal records or documents. These were working files, prepared for internal consumption, created to accumulate materials required for investigation or prosecution. As a result, they were both detailed and candid. They lacked the public relations gloss or self-serving quality characteristic of records generated specifically for public audiences.

The contents of investigative files, then, were tremendously valuable for abstracting a full and realistic sense of investigative practice. However, because they were working files, they were necessarily one-sided. They told the SEC side of the story - the perceptions of its staff of the circumstances of violation. They did not systematically tell the stories of the subjects of

investigation - their characterization of the events in question and their justifications, alibis, denials, and excuses. One is provided an occassional insight into this different "story" from testimony, records of litigation, and briefs and memos submitted by the defense. But, by and large, the records reflect SEC characterizations of the nature of investigation and its content, whatever their inaccuracies and biases. However, this is the study of a social control agency and its practices, and its story is clearly the most relevant one. Indeed, observational strategies generate the same story. The accumulation of other stories - from offenders, victims, the securities bar, the judiciary, other social control agencies, the news media - are valuable, but clearly secondary.

The materials in investigative files often presented redundant information. This "problem" was actually a welcome one, since it assisted in checks of the reliability of the materials. The files in some cases were more redundant than others. Some files were incomplete. In some instances, it was clear that records were missing. In others, the necessary records were available, but it was clear in reconstructing the events that some details were either not recorded or records of them were missing from the files. In very short order, I got a feel for record quality and for the indicators of incomplete information.

Even more serious than incomplete files, was the problem of missing files. Of the sample of 581 cases, I was unable to obtain 84 cases or 19% of the investigative files. The reasons for missing files are varied. They may simply be lost, misfiled, or never returned by a regional office or the Department of Justice; they may have been requested or are in use by other SEC personnel or by outsiders making a Freedom of Information Act request at the time they were ordered for this research; they may have been consolidated into another docketed case without proper notation of this fact. Although the number of missing files

was relatively small, data on even these investigations were available in another record system that retains a sheet of information on all docketed investigations. These sheets were consulted for all missing files and for cases with incomplete information. Usually the information reported on the sheets, coupled with examination of SEC enforcement releases, whose numbers were noted on the sheets, provided enough information to reconstruct the basic contours of the offense and the investigatory process.

Obviously, the quantity and quality of data availble varied considerably across the sample. Nonetheless, the records were incredibly rich and very complete overall, particularly given the fact that many were as much as thirty years old. A later section of this chapter describes the data items coded and, in that context, specific problems of missing data are addressed. The remainder of this chapter is concerned with specific methodological issues pertaining to the archival research.

The Research Population

The unit of analysis in the archival research phase of the data collection is the formal docketed investigation conducted by the Headquarters and regional offices of the SEC, for which a file was created and maintained. Approximately 18,000 docketed investigations were opened from the inception of the SEC in 1934 until March, 1977, when the sample was drawn.[3] In the section which follows,

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[3]This figure is not more precise because, as noted earlier, the conditions of access to the data stipulated that material relating to open investigations be excluded, and therefore their number had to be estimated. During this period, 16,271 closed investigations had been conducted. Based on the discrepancy between the number of investigations reported in annual reports and the number of closed investigations for the 1970-77 period, I estimate that about 1,400 investigations were still open when the sample was drawn. It is significant to note, however, that overall, annual report data significantly underreport the number of investigations conducted. During the 1934-70 period, for which all investigations were closed and therefore the list of closed investigations should reflect the full set of investigations, annual reports report 11,159 investigations, a count of all docketed cases yield 14,773 investigations. It

details of sampling design and the matter of inference from sample to population are considered. In the present section, a fundamentally more important question is addressed, which considers the kind of inferences that could be drawn about the nature of SEC investigative work, even if data on the entire population of docketed investigations were collected. Clearly, not all investigative work conducted by SEC staff results in a docketed case. In some instances, investigation of the same matter may be included in more than one docketed case. As a result, some kinds of investigative work may be excluded from or under-represented and others may be over-represented in the "population." The problems of inaccurate represesntation are significant, particularly where they reflect systematic patterns of exclusion. Their outcome may be inaccurate descriptive characterizations of the nature and substance of SEC work as well as potentially spurious relationships between variables that pertain to these phenomena. In this section we inquire, then, about the operational boundaries of a single investigation and about the conditions under which a docketed investigation is or is not generated.

The statement that the unit of analysis in the archival research is the "investigation" is a good deal more ambiguous than it appears. An enumeration of investigations does not tally investigative activities or violations or violators, but some mysterious and often arbitrary and inconsistent combination of these phenomena. The least common denominator that is shared by all elements in the set is that investigation is directed at some allegation or suspicion of violative activity. Among the basic information that must be provided whenever

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is unclear what subset of docketed investigations were counted when annual report figures were compiled and whether the discrepancies reflect random error or systematic exclusion. However, it is comforting to note that this research was based on the fuller enumeration of investigations. It is also comforting to note that the biggest discrepancies occurred in the early years of the SEC, a period excluded from the research sample. More about this later.

an investigation is opened are the acts or statutes potentially in violation and a brief description of the offense. It is the presence of actual allegations or focussed suspicions of illegality that is the organizing concept of the investigation, then. Whatever the source of allegations or suspicions, their specificity, or their reliability, the organization of inquiry that they generate constitutes the investigation. Hence, investigative activity that seeks or may result in the generation of allegations or suspicions - for example, market surveillance, routine scrutiny of registration statements, routine broker-dealer inspections, solicitations of other social control agencies[4] - are not reflected in an enumeration of investigations.

This least common denominator provides a criterion according to which investigative activity potentially subject to docketing can be separated out from that which is not. But it tells us nothing about the criteria according to which only a portion of the former category are ultimately docketed, and nothing about the process by which these inquiries get sorted and assigned to one or more cases. Given our concern for the representation of investigations in the research population, it provides no insight, in other words, into the possibility of under or over-representation.

"Under-Representation"

What investigations escape docketing? This question is difficult to answer because it requires examination of the very data that are excluded from the data set. The answer, therefore, is based on other sources: SEC annual reports, other record systems, proxy indicators, and conjecture. These materials are admittedly incomplete and superficial. Whatever the quality of data and the resulting precision of our estimates, it is clear that a large number of

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[4]These activities are considered in greater detail in Chapter 5.

potential inquiries fail to be docketed. Annual reports indicate the receipt and examination of thousands or tens of thousands of complaint letters each year at the Headquarters Office of the SEC alone, when at most a couple hundred investigations across all regions are docketed. Annual reports also indicate that hundreds of violations are uncovered during SEC broker-dealer inspections, more violations than the total number of docketed investigations pertaining to violations of all kinds by all parties. Assuming that allegations or discoveries of this kind occasion some amount of investigative work, it is clear that a large number of them are slipping through the docketing process and are not counted among population elements.

Prior to 1962, investigative matters were handled in one of three ways: they were docketed, they were designated "preliminary investigations," or they were conducted informally without generating a record.[5] Preliminary investigations pertained to the earliest stages of investigative activity, and were based primarily on correspondence and limited field work (Annual Report 1946, p. 111). At the conclusion of a preliminary investigation, the matter was either closed or was docketed as a full investigation. Not all docketed investigations began as preliminary investigations and not all preliminary investigations were transferred into docketed ones. And, of course, not all investigations were designated preliminary or docketed. However, some scrutiny of preliminary investigations and an examination of how they differ from docketed investigations and of differences between those preliminary investigations closed without formal action and those ultimately docketed should provide some sense for the qualities of investigations excluded from the population, at least prior to 1962 when this category was dropped in SEC record

[5]After 1962, the "preliminary investigation" label was dropped. Presumably investigations of this kind continue to be conducted informally without any enumeration or formal record keeping.

systems.

SEC annual reports describe the "preliminary investigation" as the process used to determine whether probable violations have occurred, carried on largely by correspondence, office research, or limited interviews (1950, p. 151-2). Investigative activities may involve examination of Commission files, correspondence with persons who have information on the subject, telephone inquiries, or personal interviews with a limited number of persons (1955, p. 114). These reports do not describe the conditions under which the opening of a preliminary investigation is appropriate. They do suggest, however, that it is sometimes appropriate to immediately docket an investigation, bypassing the preliminary phase. This is the case where it is determined at the outset that an extensive investigation is warranted (1951, p. 154). There is no discussion of the indicators of such a situation, of the kind of scenario that might occasion an immediate docketed investigation. Annual reports leave both these scenarios - under which preliminary or docketed investigations are undertaken - to our imagination. We do know, however, that the opening of preliminary investigations is less likely than the opening of docketed ones. Between 1939 and 1962, annual report figures indicate a ratio of docketed to preliminary investigations of 1.39 (6409 vs. 4608), or proportions of all investigations of 58% vs. 42%, respectively. Of course, we have no idea how many investigations were never designated preliminary or docketed.

Preliminary investigations must end, of course, and one possible form of termination is transferring them out of this category and assigning them a docket number. Annual report figures (available between 1945 and 1962) indicate that 19% of the preliminary investigations (N=687) are finally docketed. Of the pool of all investigations ultimately docketed during this period, 13% began as preliminary investigations; 87% were docketed initially. The annual reports

describe the termination of preliminary investigations and the conditions under which docketing is appropriate. Preliminary investigations are simply closed where they disclose that the violation, if any, is minor, warranting neither a full-scale investigation nor the imposition of any of the sanctions provided by law; where the violation comes to the attention of the Commission shortly after its inception; where the violation is inadvertent; or where the offender has taken steps to comply with the law (1950, p. 152). The concluded preliminary investigation serves to educate the public and inadvertent violators, to prevent the continuance of minor violations, and to bring about compliance before any damage or loss results to the investing public (1951, p. 155; 1953, p. 104). However, where the necessary evidence to determine whether a violation has occurred is not readily developed by a preliminary investigation (1960, p. 201); where more extensive investigation is required (1961, p. 173); where investigation reveals a wide-spread public interest or the likelihood of a substantial violation (1953, p. 105); or where the matter cannot be disposed satisfactorily (1955, p. 114), the preliminary investigation is docketed and a full investigation is undertaken.

One gets a sense from these descriptions that, where initial allegations indicate minor investigative effort and where minor or inadvertent violations of insignificant public interest are found and offenders agree to cease violations and/or agree to other informal remedies, these investigative efforts escape from formal recording via inclusion in the population of docketed cases. This observation is most likely true of both investigations designated "preliminary" and those conducted more informally.

These descriptions obtained from public relations documents are useful and provide some sense for the conditions under which the population was generated. But they describe a uniformity of policy which is somewhat implausible. If

accurate, they provide some sense for typical behavior, but none for exceptions to the rule. The fact that there may be considerable variability in docketing policy is implied in Table 2.1. The first two columns of the table provide indicators of rates of preliminary investigation by regional office, column (a) as a proportion of all investigations and column (b) as a proportion of all docketed investigations. The figures suggest considerable variation by region - by as much as 46%. For example, almost half of all investigations and more than a third of all docketed investigations in San Franscisco were first preliminary, in contrast to proportions of 6% and 8%, respectively, in Fort Worth. Column (c) provides a somewhat different insight. It reports the amount of time that evolves between the institution of investigation and docketing (irrespective of preliminary investigation) by region. Presumably, regions that are quick to docket may generate a rather different pool of cases than those that only docket after considerable investigation. The data gain reveal substantial differences. Although the offices do not order themselves in similar fashion to rates of preliminary investigation, they are quite distinctive. Within one and one half months of investigation, three-quarters of all of Boston's docketed investigations have been docketed in contrast to only a quarter of those in San Franscisco, Chicago, and Washington.

Now there are all kinds of plausible explanations for these differences, for example, regional differences in patterns of illegality that necessitate different investigative procedures. But with differences this big and their patterning seemingly so arbitrary, one has to begin to wonder whether their magnitude actually reflects idiosyncratic regional office policy. It may well be the case that an identical investigation may be immediately docketed in Fort Worth and first designated preliminary in San Franscisco. Or it may be immediately docketed in Boston and never docketed in San Franscisco, Chicago,

TABLE 2.1: REGIONAL OFFICE DIFFERENCES IN DOCKETING POLICY

Regional Office	(a) % Preliminary of all Investigations*	(b) % Docketed Cases Originally Preliminary*	(c) % Cases Opened After 1 1/2 Months of Investigation***
Headquarters	0%	9%	36%
Ft. Worth	6%	8%	40%
Seattle	11%	8%	55%
Washington (D.C.)	16%	21%	27%
Boston	18%	8%	75%
Chicago	18%	17%	26%
Denver	20%	20%	52%
Atlanta	23%	0%	34%
New York	27%	38%	50%
San Franscisco	46%	36%	25%

*1934-1962. Data Source: SEC investigation listing.

** 1948-1962. Data Source: Research Sample.

*** 1948-1972. Data Source: Research Sample.

and Washington, because further investigation indicated that it was trivial. To the extent that this is the case, one begins to wonder whether the patterns reported in annual reports really hold very often. And one becomes nervous that significant investigations in one region may be excluded from the population while insignificant ones in another region are included as a result of variable regional office docketing procedures. Of course, the data upon which the reasonable extent of our nervousness could be ascertained are necessarily unavailable.

Implicit in the distinctions presented in Table 2.1 are two "proxy" measures that allow some empirical reflection on correlates of docketing practice. These consider differences (1) between docketed cases that were not and those that were first investigated preliminarily,[6] and (2) between docketed cases that were quickly docketed after investigation began and those that were not.[7] The data base here is the research sample. The assumption is, that in each index, the former category (preliminary investigation/slow docketing) represents a class of cases most vulnerable to exclusion from the population because of the greater opportunities to terminate investigation before docketing. The assumption is a bit risky, however, because these cases were ultimately included, and they may bear little correspondence to their counterparts that were, in fact, ultimtely excluded.

The data are not particularly impressive. Very few characteristics, either of the nature of the violative activities or of the case disposition, are correlated with these proxy measures. The findings generally suggest that, as

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[6]Of the 228 docketed cases in the sample reflecting the 1948 (when the research begins) to 1962 (when preliminary investigations are no longer recorded) period, 60, or 22% began as preliminary investigations.

[7]The length of investigation prior to docketing ranged from a day or two to in excess of a year. The median length was 57 days.

long as an investigation is ultimately docketed, the preceding investigative history does not especially matter. However, some differences are worthy of note. The data indicate that investigations in the category of preliminary investigation/slow docketing are less likely to involve technical violations of SEC regulations than major fraudulent schemes, and more likely to involve a greater complexity of violative activity, a greater amount of money involved in the violation, and a larger number of participating offenders. It appears, then, that more serious cases fall into this category, a seemingly counter-intuitive observation. In fact, the finding probably reflects the difficulty of determining whether a significant violation has occurred where offenses are complex, and hence, the delay in docketing.

A more significant pattern is revealed in this analysis, reflected in the correlation of these proxy measures with the source of investigation. The data indicate that the manner in which initial allegations or suspicions are generated is related to the docketing process. For example, during the 1948-62 period, 38% of those docketed investigations instituted by investor complaints were first assigned preliminary investigation in contrast to 16% of all other investigations. This pattern is mirrored in the analysis of the proxy measure, length before docketing. Twenty-eight percent of those cases instituted by investor complaints (1948-72) were docketed within one and one half months in contrast to 49% of all other investigations. In other words, it takes longer to docket an inquiry based on investor complaints. Perhaps these inquiries are more likely to be excluded from the population. This pattern is reversed for cases instituted by referrals by insiders in illegal activities. The rates of preliminary investigation are 17% (for insiders) versus 23% (for all others) and the proportions of cases docketed in one and one half months are 63% (for insiders) versus 42% (for all others). There are smaller, but still

significant, differences among other sources of allegation or suspicion.

Now, clearly, different investigative sources generate different kinds of allegations, some of which are presumably more worthy of or appropriate for investigation. It is not surprising, for example, that investor complaints are not immediately docketed, given the fact that tens of thousands of them are received each year. But this means that patterns of exclusion from the population may be correlated with characteristics of investigative source. This is especially troubling because this source variable is central to later analysis.

This observation, based on empirical material, concerning the relationship of the source of investigation to inclusion in the population suggests that a closer consideration of the development of an allegation is appropriate. The implicit investigative model considered in this section has been one in which allegations of illegality by a party or parties suddenly surface - whether through a complaint, referral, etc. - and require new investigative effort. This model may be appropriate when the development of suspicions occurs outside of the SEC and they are subsequently referred to the agency as matters about which inquiry can be immediately directed. In short, they meet the lowest common denominator, described earlier. But what happens when suspicions are developed in-house, in the course of other regulatory activity?

Consider two scenarios. Special SEC staff in the Headquarters and the regions are routinely deployed in accordance with legal requirements to conduct periodic inspections of broker-dealer offices. In the course of the inspections a host of illegalities may be uncovered - of different magnitudes, degrees of seriousness, inadvertence, and the like. However, it is unlikely that on the first blush, staff members will return to their offices, call in different enforcement personnel, and institute a formal investigation. Rather, they may

advise broker-dealer management on site about the abuses and problems uncovered and request their compliance. It may be that only after continued non-compliance or the discovery of serious offenses that implicate parties outside of the brokerage firms, that formal investigative activities may be initiated.

The second scenario considers the matter of registration of stock offerings with the SEC. Again, a special staff is organized for facilitating registration and for examining the prospectuses and other materials submitted by potential registrants. Often this process is one of negotiation. Attorneys for the proposed issuer consult with SEC staff during the preparation of materials. SEC staff comment on problems they find in these materials. And issuers subsequently revise their prospectuses before the offering becomes effective. What might have been glaring misrepresentations in registration materials may be eliminated in the final offering as a result of this negotiation process. Again, it is unlikely that these SEC staff will immediately refer an apparently fraudulent prospectus to a different division for formal investigation. They may first attempt to secure corrective behavior by these parties.

In both examples, the activities of agency personnel were routine. They did not begin as <u>investigations</u>; there were no allegations or suspicions around which scrutiny was directed. It appears, then, that investigative-like activities pertaining to parties bearing some relationship to the agency are more immune to docketing than those pertaining to outsiders. In both scenarios, where parties bore some relationship to the agency, there were alternative responses to violation besides investigation. Where unregistered (and therefore unrelated) issuers allegedly use fraudulent prospectuses, there is no alternative to investigation because there is no ongoing relationship in which corrective action can be secured. Perhaps that is why such a high proportion of

the fraudulent schemes included in the research sample also contain registration violations. Perhaps that is also why the research sample contains such a dearth of investigations of large and highly visible corporations which are registered with the SEC. Their misdeeds are not necessarily covered up. They are perhaps simply handled outside of investigative channels.

In a similar vein, a large number of docketed investigations of broker-dealers concern their failure to file annual reports, a rather trivial violation on its face. The reason why these cases outnumber more serious and conceivably as numerous technical violations uncovered during inspections derives precisely from the "relationship" hypotheses. By failing to file a report, even after warnings, and thus indicating the possibility of its demise, the firm has called this relationship into question. There is no ongoing stream of communication in which staff can advise the firm to submit its report in the same way that an inspector can advise compliance with other regulations during the firm's inspection. Formal investigation becomes the alternative.

This last discussion is based entirely on conjecture. There are no data available which pertain to the nature of response to violation uncovered in the course of regulatory activity. It may simply be that regulated parties violate less frequently than non-regulated parties and hence are less often subject to investigation. But my sense is that these conjectures are rather realistic. In any event, the explorations in the previous pages - of annual reports, empirical data, and proxy measures - suggest that the composition of elements in the population of docketed investigations is indeed problematic. We have come to suspect that inclusion in the population may be arbitrary and idiosyncratic, reflecting informal office practices of the region in which investigation is conducted. But inclusion may reflect systematic patterns as well, particularly concerning the source of allegations or suspicions and the manner in which they

were generated. Suspicions developed by SEC staff, other social control agencies, and insiders in illegality may be less immune to docketing than those developed by the victims of illegality. But illegalities uncovered by SEC staff in the course of other regulatory activity may be relatively immunized from docketing as well.

If we consider, not the nature of the investigative process, but rather the behavior subject to investigation, a striking paradox emerges. Docketing, it seems, excludes both the most trivial and perhaps the most significant of cases. Much of the annual report discussion of preliminary investigations, as well as common sense, indicate that minor violations with little impact are less likely to be docketed than those of greater significance. On the other hand, the observation that "outsiders" are more likely subject to docketed investigation than "insiders" may cut the other way. It may direct attention to dying organizations (rather than to on-going ones), whose failure to maintain normal ties of communication with the agency result in investigation rather than some other mode of control. It may direct attention to small newly emerging corporations who fail to register their securities with the agency rather than to huge, important registered corporations. Even if the two corporations commit the same offense, it is likely that the number of victims involved would be considerably greater for the larger, established corporation, and hence the offense somewhat more significant. The insider/outsider phenomenon results as well in the fact that the population will contain investigations of abuses by outsiders of "Fortune 500" corporations - for example, a scheme to manipulate their stock - but few investigations of the abuses of these corporations themselves - for example, disclosure problems or management fraud.

These observations do not necessarily suggest biases or inequities in the application of social control. Indeed, all of these abuses, from the most

trivial to the most significant, when uncovered by the agency, may be responded to with some combination of compliance, corrective behavior, and sanction. What they do suggest, however, is that the investigation is a peculiar form of response that may not be applied universally across abuses. The fact is that systematic patterns of exclusion from the population of docketed investigations probably do exist. The fear of under-representation is justified. The most common targets of under-representation have been described above.

"Over-Representation"

In the previous section, the conditions under which an investigation would or would not be included in the population of docketed cases was considered. In this section, we consider that subgroup of docketed investigations and inquire about the definition of a case and the number of cases an investigation might generate. The ambiguity in case definition derives from the rather peculiar association of allegations and the investigative activity that is captured in the docketed investigation. The investigation is generated, not in response to particular illegalities or particular offenders, but rather to particular allegations. What happens when separate investigations of different allegations uncover the same offense and the same offender? What happens when the investigation of a single allegation uncovers new unrelated offenses and offenders? What are the administrative consequences of an offense that generates a single allegation and a single investigation and an identical offense that generates several allegations and therefore several investigations?

The structure of securities violations complicates this process. Because these offenses commonly involve a series of different illegal activities enacted over a period of time, by a number of different actors, victimizing a number of different parties, there are multiple opportunities for the generation of allegations or suspicions. Consider the following hypothetical case.

> A half dozen persons affiliated with a stock issuer selling oil mining stocks team up with two brokerage firms to market these securities. They are assisted in the creation of promotional materials by an investment advisor, an attorney, an accountant, and a geologist. This promotion, which is not registered with the SEC, is a fraudulent scheme, in which representations about the tremendous prospects of the mining property are touted. In fact, the wells are dry. In early 1970, several thousand investors in the Fort Worth area are solicited; in late 1970, the promotion moves to New York and Pennsylvania. All of these participants conspire in this aspect of the scheme. However, other violations are occurring as well. Some of the insiders in the issuer are engaged in self-dealing - channeling investment funds into an oil drilling firm they control. The brokers are engaging in high pressure boiler room sales tactics and are failing to properly record the transactions they consummate. In addition, one of their employees is embezzling investor funds. This is not the only such scheme in which the brokers and investment advisors have participated. They are simultaneously involved in the promotion of several similar mining frauds.

This particular violation could be reflected in three separate docketing patterns:

(1) A single investigation is opened which encompasses all aspects of the offense, the offenders, and their prosecution;

(2) A single investigation is opened, but subsequently additional investigations are opened to cover the diversity of offenses, the diversity of offenders, the different regions in which offense occurred, and/or the eventuality of multiple forms of prosecution; and

(3) Several investigations are initially opened either because different allegations (of broker embezzlement or of self-dealing or of misrepresentations) did not reflect the interrelation of these abuses or because different regions investigated the same allegations, unbeknownst to the others.

The investigative activities directed at this offense, then, could generate anywhere from one to a half-dozen different docketed cases. In some instances, because of their interrelationship, the cases are ultimately consolidated into a new case or into one of these initially opened. Regardless of the form of

consolidation, however, the component docket numbers are not obliterated; they remain elements in the population.

Now it is unclear from a conceptual or theoretical perspective what number of docketed investigations is appropriate in this instance. What is clear from a practical point of view, however, is that during the period covered by the research, there was no policy or system within the agency to govern this assignment. The conditions under which a single investigation was split into several appear purely arbitrary. The number of separate allegations generated about an offense is for the most part responsive to offense related characteristics. But the number of separate investigations these allegations generate is based on such factors as the speed with which a regional office dockets an investigation, the propensity for it to first assign preliminary investigations, and the like. This observation is troubling because it suggests that, for relatively arbitrary or fortuitous reasons, a "case" may have any of several "weights" in the population. It may have one docket number or ten, and this fact is directly related to the probability that the case would be included in a research sample. To the extent that weighting is not random, that case related characteristics are correlated with the number of times the case appears in the population, serious problems of inference are introduced.

The research sample provides some insights into the extent and patterning of this phenomenon of multiple docketing. For each case in the sample, data were recorded on any related docketed investigations and on the nature of the relationship between these cases. At least one-fifth of all cases in the sample were in some way related to one or more docketed cases in the population. This is a conservative estimate, in that it only includes those instances in which investigative records explicitly indicate the relationship of other docketed investigations. Perhaps a more reasonable estimate would be 30-40%, though this

figure is largely speculative.

Of the 124 cases in the sample in which there was an explicit indication of a relationship with other cases, 43, or 35%, of these cases were opened as an extension of an already ongoing investigation concerned with the initial allegations. New cases were opened presumably to reflect the multiplicity of offenders, regions of investigation, or modes of prosecution necessitated by the original case. Another 38% of these cases (N=47) were opened in response to unrelated violations discovered in the course of a previous investigation. The remaining 34 cases (27%) reflect the initial investigations from which additional cases were generated.

Although the absolute number of cases of the kind described above may be indeterminate, it is necessary to explore whether they differ in any systematic way from cases for which there is no record of relationship with other investigations. Patterns in multiple docketing across regional offices are considered as well as the relationship of multiple docketing to case magnitude and disposition.

First, do patterns of multiple docketing, like those of non-docketing, reflect idiosyncratic and arbitrary policies that vary by regional office? Table 2.2 provides data on this question. Column (1) pertains to those cases for which there is no record of multiple docketing, column (2) to all those cases in which multiple docketing is indicated, and columns (3) - (5) break down this latter category according to the distinctions introduced above. The data presented in Table 2.2 indicate somewhat less variability across regional offices in multiple docketing than that observed with regard to non-docketing. Nonetheless, two of the offices stand out as quite atypical. More than half of the investigations conducted by the Headquarters Office and 38% of those by the Fort Worth office were related to other investigations in the population, in

TABLE 2.2: MULTIPLE DOCKETING BY REGIONAL OFFICE

Region	(N)	NONE (1)	Total (2)	MULTIPLE DOCKETING Original Case (3)	New Case Related Violations (4)	New Case Unrelated Violations (5)
Headquarters	(36)	47%	53%	6%	33%	14%
Ft. Worth	(53)	62%	38%	11%	17%	9%
Denver	(55)	76%	24%	7%	6%	11%
Atlanta	(35)	77%	23%	6%	11%	6%
New York	(171)	78%	22%	7%	5%	9%
Seattle	(67)	85%	15%	4%	0%	10%
San Francisco	(38)	87%	13%	3%	5%	5%
Chicago	(64)	89%	11%	3%	6%	2%
Washington	(37)	92%	8%	5%	0%	3%
Boston	(25)	92%	8%	0%	0%	8%
Total	(581)	79%	21%	6%	7%	8%

contrast to 17% of all other regional offices. In both regions, an unusually high proportion of cases (33% and 17%, respectively, relative to 4% in the other offices) were opened simply as extensions of already ongoing investigations. In Fort Worth, these were mostly extensions of its own cases; in the Headquarters they were extensions of investigations conducted in other offices, since the proportion of cases generating new investigations (column 3) is high in Fort Worth and normal in the Headquarters. For the Headquarters Office, this finding probably reflects the fact that multiregional investigations are sometimes consolidated in a new Headquarters case. An explanation of the Fort Worth pattern is less apparent. Nonetheless, the data suggest that cases docketed in these two offices are redundant. They record investigative activity already recorded in other docketed cases. Overall, it is unclear whether the source of regional office differences is idiosyncratic docketing policies or rather differences in the nature of the caseload of the various offices.

The phenomenon of multiple docketing is correlated as well with substantive characteristics of investigations, particularly with aspects of the magnitude of a case and with case disposition. These relationships are presented in Tables 2.3 and 2.4. As one might expect, as elements of an investigation become greater, the likelihood that that case will be related to others increases. However, this relationship reflects more than the fact that when a case gets too big, it is broken up into additional docketed cases. Magnitude correlates as well with newly docketed investigations of unrelated violations. Table 2.3 clearly demonstrates that, whatever the indicator of case magnitude - the sheer quantity of investigative work, the number of participants in illegality, the extent to which more than one kind of organization and more than one kind of actor, are investigated, the number of violations under investigation, or the amount of money involved in the illegality - the proportion of big cases is

TABLE 2.3: MULTIPLE DOCKETING AND ASPECTS OF THE MAGNITUDE OF ILLEGALITY/INVESTIGATION

	NONE	MULTIPLE DOCKETING				TOTAL
		Total	Original Case	New Case Related Violations	New Case Unrelated Violations	
	(1)	(2)	(3)	(4)	(5)	
1. Magnitude of Investigation % Large	9%	22%	35%	19%	15%	12%
2. # of Participants in Illegality % More Than 3	33%	59%	82%	40%	60%	38%
3. # of Different Organizations % More Than 1	21%	38%	50%	28%	38%	25%
4. Variation in Kinds of Participants % Both Issuers and Brokers Participate	10%	30%	41%	23%	28%	14%
5. Variation in Kinds of Violations % More Than One Type Violation	55%	72%	82%	76%	62%	59%
6. Amount of Money Involved in Violation % More Than $500,000	18%	4%	36%	48%	18%	22%
(N)	(457)	(124)	(34)	(43)	(47)	(581)

higher (by 13% to 26%) for investigations related to other docketed cases than for unrelated cases (column 2 minus column 1). Furthermore, where magnitude pertains to offender characteristics, the biggest cases are those that generate other cases (column 3) followed by those cases generated to explore new violations (column 5). For other aspects of magnitude, the biggest cases are those generated to pursue related violations (column 4). These findings suggest, then, that "bigger" cases may be over-represented in the sample.

Case disposition is another significant correlate of the multiple docketing of cases. As indicated in Table 2.4, the likelihood of formal legal action is substantially lower for cases unrelated to others in the population (46%) than for related cases (64%). This probably reflects the fact, noted earlier, that some cases are generated specifically to handle additional forms of prosecution to that pursued in the original case. Hence, 70% of those new cases with related violations (column 4) are ultimately prosecuted as are 68% of those cases that generate new ones (column 3). One would expect to find higher rates of prosecution for new investigations of unrelated violations generated from other investigations than for investigations created de nouveau (55% versus 46%). This is so because in the former case, previous investigation provided some sense for the severity of the offense and the need to investigate it further, data absent for entirely new investigations. The table indicates that all forms of legal action - civil, administrative, and criminal - are more likely among interrelated cases than among unrelated cases.[8] It indicates as well that the likelihood of multiple forms of legal action is higher for multiply docketed cases - an expected finding, since the multiplicity of

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[8]Administrative proceedings are especially common (47%) for generated cases with related violations, as noted in the table. This is so because new cases are often opened specifically to handle administrative proceedings against broker-dealers involved in cases concerned primarily with stock issuers.

TABLE 2.4: MULTIPLE DOCKETING AND CASE DISPOSITION

	NONE	MULTIPLE DOCKETING				TOTAL
		Total	Original Case	New Case Related Violations	New Case Unrelated Violations	
	(1)	(2)	(3)	(4)	(5)	
% Formal Legal Action Taken	46%	64%	68%	70%	55%	50%
% Civil Action	22%	27%	26%	26%	30%	23%
% Administrative Proceedings	17%	33%	32%	47%	21%	20%
% Criminal Prosecution	17%	27%	29%	26%	27%	19%
% More than one Form of Legal Action	8%	21%	21%	23%	19%	11%
(N)	(457)	(124)	(34)	(43)	(47)	(581)

prosecution is often the occasion for new docketing. An alternative explanation for higher rates of prosecution among related cases derives from the correlation between prosecution and case magnitude documented elsewhere (Shapiro, 1978a). Hence, the correlation of prosecution and case interrelationship may be a spurious one. Nonetheless, this pattern, whatever its source, indicates that prosecuted cases may be over-represented in the population, since matters included in more than one docketed case have higher rates of prosecution than those included in a single docketed case.

Population Elements

The previous consideration of the nature of possible over- or under-representation of elements in the population painted a rather bizarre portrait of the investigation as unit of analysis in this research. First, it seems impossible to identify the criteria that define a single investigation. Second, the circumstances under which it is generated, no matter how fortuitous or arbitrary, seem critical in determining whether or not it will enter the population and if so, how many times it will do so. Both of these observations suggest that the investigation, as created by SEC staff, may pose peculiar inferential problems in attempting to generalize to some notion of SEC enforcement practice. But the appropriate response is not to abandon the analytic unit reflected in the investigation, but rather to acknowledge what we should have known all along - that the investigation is only one context in which social control activities can be displayed. And had we chosen another context or another manifestation of social control activity as the unit of analysis, we would have faced very similar problems of ascertaining what is included or excluded and specifying what constitutes the boundaries of a single event or unit.

The previous discussion has facilitated our appreciation of these stubborn

problems, but it has also served to clarify some of them. There indeed appear to be systematic patterns of over- and under-representation. But some of these patterns appear to cancel each other out. Both trivial and significant cases seem more vulnerable to exclusion. However significant matters also seem more vulnerable to over-representation by their assignment to multiple cases. The investigation, then, serves as a forum for the display of a wide variety of illegalities and agency responses to them. If we concern ourselves primarily with exploiting this rich resource to learn about the agency and only secondarily with inferential issues, our research will be all the more valuable.

Sampling

An enumeration of elements of the population of docketed investigations was provided by a computer tape developed by the SEC for case management, documentation, and data retrieval. I was given an extract of this tape listing all closed cases in the population by docket number, the regional office conducting the investigation, and dates on which each case was opened and closed. The sample was drawn from this listing.

The evolution of a sampling design was guided by two considerations: (1) a desire to exclude extraneous variability that might complicate the analysis of a necessarily small sample of data, and (2) a desire that the biases inherent in the exclusion of still open investigations be minimized. The concern inherent in the first consideration was that, since the population of investigations reflected over forty years of agency history, ten different regional offices, dozens of kinds of violative activity, a variety of different kinds of organizations and persons under investigation, three modes of formal legal action, and the like, the sample would contain so much variability that there would be few cases left for analysis after control variables were introduced. As a result, the possibility of excluding certain kinds of investigations from

the sample or of assigning different weights to population elements was seriously considered. It was abandoned for two reasons: (1) insufficient quantity and quality of documentation of population elements upon which selection could be based, and (2) the lack of a priori theory that could guide the development of selective criteria.

The full SEC computer tape from which the extract tape was made contained a variety of other kinds of information about the investigative process and case disposition which might have been employed for purposes of sampling. My request for access to most of this information was denied. An examination of a portion of the tape which pertained to statutory violations revealed a considerable amount of missing data and an unsystematic and haphazard recording of information. Even if the full tape were available, it is likely that data quality would have been too low to justify its use for selective sampling. Utilization of this material would have cost more in the introduction of bias in the sample from inaccurate, incomplete, and missing data than it would have contributed by homogenizing its elements.

Thus, the only reliable data upon which selective sampling could have been based pertained to regional office and date of investigation. Very little is known about SEC regional offices, particularly over its forty odd year history. Annual reports are written as though the SEC was one big national office. They do not even break down offices by numbers of personnel or resources, let alone by differences in enforcement strategy or caseload. A decision to exclude or differentially weight particular regional offices in sampling would have been largely arbitrary, and therefore was abandoned.

The possibility of sampling by date of investigation brings us to the second consideration underlying sample design: a desire that the biases inherent in the exclusion of still open cases be minimized. SEC investigations

tend to continue for considerable periods of time. An examination of the dates on which investigations are opened and closed, listed on the extract tape, reveals that the median case is closed within 2 years, although as many as 15% of the cases remain open for five years or more. As a result, it should be no surprise that the denial of access to open investigations resulted in a sharply reduced sample of cases reflecting contemporary investigative activity. Table 2.5 contrasts the number of closed investigations that were initiated in the last ten years with the total number of investigations opened during this period. As the table clearly shows, less than 43% of the investigations

TABLE 2.5: THE PROPORTION OF CLOSED INVESTIGATIONS, 1967-1977

Fiscal Year	# Investigations Opened*	# Investigations Closed by 3/77	% Closed
1967	390	378	97%
1968	357	348	97%
1969	361	340	94%
1970	408	371	91%
1971	410	372	91%
1972	374	304	81%
1973	472	339	72%
1974	382	227	59%
1975	490	183	37%
1976	413	69	17%
1977	?	4	?

*Source: SEC Annual Reports, 1967-1976.

instituted since July, 1972 had been closed by March, 1977, and would therefore be included in the "population" listing. If cases closed in random fashion, this observation would not be very troubling since it would be possible to correct for this problem through weighting. They do not, however. Indeed,

cases involving larger corporations as violators, more complex, widespread, or long-term patterns of illegality, more serious violations, extended litigation, multiple forms of social control, particularly criminal modes of disposition, and so forth, are probably slower to close. The inclusion of cases opened during the mid-seventies, then, would bias and probably trivialize the sample by overweighting the short investigation and its related set of characteristics.

In order to minimize bias of this sort, cases opened in most recent years were excluded from the sample. Choice of a precise cut-off date also considered a major reorganization of the Commission in August, 1972 that resulted in the creation of a separate Division of Enforcement, for the first time in Commission history,[9] and the introduction of new procedures in the enforcement process resulting from a review and evaluation of SEC enforcement practice conducted during the same year (Wells, 1972). Given the possibility of a rather substantial effect of reorganization on subsequent enforcement activity, coupled with increasingly low proportions of closed cases after this date, 1972 was chosen as a cut-off date for sampling purposes. All cases open after December, 1972 were excluded from the "population" from which a sample was drawn.

As long as sampling was selective with regard to period of investigation in recent years, scrutiny of enforcement issues in the Commission's early years was deemed appropriate. Although the agency was created in 1934, the full arsenal of statutory provisions typically utilized in enforcement prosecutions was not complete until 1942. However, this date puts us in the middle of the Second World War, which had considerable impact on the operation and resources of the

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[9]Previously, enforcement functions were exercised by each of the SEC "substantive" divisions, though particularly the Division of Trading and Markets. The reorganization vested jurisdiction over disclosure and regulatory matters in the Divisions of Market Regulation, Corporate Regulation, Investment Company Regulation, and Corporate Finance, and enforcement matters in the new Division of Enforcement.

Commission available for enforcement as well as on the opportunities for illegality. The war years (1942-47) also witnessed a temporary move of the central offices of the SEC from Washington, D.C. to Philadelphia, after which the Commission was again headquartered in Washington. In addition to the end of the war and resettlement of the agency, 1948 marks the first year in which the SEC was chaired by a non-Roosevelt appointee,[10] signalling perhaps the end of the era of Roosevelt influence on this agency, a creation of his administration.

These somewhat arbitrary, though not frivolous, considerations resulted in the selection of the twenty-five year period from 1948 to 1972 as the period from which the sample would be drawn and to which research findings would generalize. Obviously, significant factors intervened in the twenty-five year period - major amendments to the securities laws (especially those of 1954 and 1964), drastic changes in the economy, in the state of the securities markets, and in the condition of the professional organizations which service them, and obvious changes in Presidential administration and social conditions. They cannot all be controlled, but research will try to be sensitive to these changes. Since there is no a priori reason to believe that a given era is more significant than another, the rationale has been to be as inclusive as possible. Certainly a narrow circumscription of years would present fewer problems, but also fewer generalizable findings.

The listing of closed cases includes 8,117 investigations opened between January, 1948 and December, 1972.[11] Utilizing a sampling fraction of

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[10] Four of the five Commissioners in 1948 were Truman appointees. By mid-1949, all SEC Commissioners were Truman appointees.

[11] In the event that the date in which investigation was opened was missing from the extract tape, closing dates were utilized. Cases that were closed between 1950 and 1974 were also included in the sub-population from which the sample was drawn.

one-eighth, a simple random sample of 1,044 cases was drawn.[12] Selection was made without reference to any other case characteristics, and the probability of inclusion in the sample was equal for all cases opened during this time period. The desired target sample was only 500 cases, but a larger sample was drawn in the event that a substantial number of cases were missing or that data collection proceeded more quickly than expected, hence permitting extra data collection. The 1,044 cases were randomly ordered through use of a random numbers table (The Rand Corporation 1955), and investigations were coded in this order. This procedure also insured against bias in the sample introduced in the event that data collection was terminated prematurely.[13] However, it also insured that biases introduced by the growing sophistication of the coder over time would be randomly distributed across the sample.

Data on the first 526 cases in the randomly ordered sample were collected and coded when it was deemed appropriate to stop data collection. Hence, the actual sampling fraction was one-sixteenth. However, a preliminary examination of these cases revealed a very low proportion (11% or 58 cases) of investigations that resulted in criminal prosecution. Since a special consideration of criminal cases had been anticipated as an important element of the analysis, it seemed appropriate to increase the N of this subgroup. Using a supplementary data source, separate from the investigative files, summary records on each of the remaining 518 cases in the original (1/8) sample were

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[12]A Statistical Package for the Social Sciences subroutine was utilized in drawing the sample (Nie et al. 1975, p. 128). The sub-population and the sample were contrasted on a number of variables coded on the extract tape. Percentage differences between sub-population and sample on any given category never exceeded one percent. Means, medians, modes, and standard deviations were remarkably similar.

[13]The older records had been scheduled for destruction about two months after data collection began. Thay had not, however, been destroyed when data collection was completed.

examined to determine which of them were disposed criminally. This resulted in a sub-sample of 55 cases (also 11% - of the 518 cases) which were referred for criminal prosecution. The full investigative files of these cases were ordered and the same data as those collected for the original sample were obtained. As a result, data on 581 cases were actually collected. While the sampling fraction for non-criminal cases is one-sixteenth, it is, therefore, one-eighth for criminal cases. Most of the analysis presented in the dissertation are based only on the original sample of 526 cases. The reader will be advised where the criminal subfile is included in the analysis (whether or not it is weighted).

With the exception of a small number of investigations excluded because they were still open, a full listing of the population of investigations opened between 1948 and 1972 served as the basis of the creation of the sample. This is one of the few cases in social science research where one can confidently say that the assumptions of simple random sampling have been met. The true inferential problems in this research, then, derive not from statistical issues, but rather from those presented in the previous section concerned with a sense for the boundaries of the population.

An aside on random sampling. A word about random sampling is in order. This aside is perhaps more relevant for the reader trained in law than in social science. The choice of random criteria in the selection of the research sample requires little justification for social science audiences. Indeed it would be the absence of random criteria that would require justification, because it would mean the impossibility or extreme difficulty of drawing inferences about the larger population on the basis of sample data. However, it would be rather strange indeed if a casebook in securities law was based on a random sample of all securities litigation or even if SEC annual reports commented on a random

sample of the year's cases rather than its most significant ground-breaking cases.[14] That derives from the fact that the logic of legal reasoning and that of scientific reasoning is rather different. What is at first precedent in law is at first deviance in science. Now, one could do a fascinating scientific study of precedent setting cases - by drawing a random sample of a listing of all of these cases. But that would be a different study. The one reported here is concerned with the typicality of investigative work, not its unique examples. Once one has a sense for the contours of investigative work, for common patterns, for what is not distinctive, for the endlessly repeated redundant activities that escape canonization in a casebook, one can begin to explore the distinctive ripples in the otherwise uneventful flow of events. One can ask when these "ripples" typically occur, what accounts for their occurrence, what is their substance, what are the patterns and processes according to which they become normalized and typical, and so on.

These observations are perhaps common-sensical. But their implications are radical. One gets an extremely different sense of reality from sampling the typical than the unusual, the frequent than the infrequent. If I had listed the names of the 581 cases in the sample (which I could not because of assurances of confidentiality) even the finest scholar of securities law would recognize very few of the cases. And that is because they are not distinctive. These data, therefore, will look very unfamilar to the lawyer. But they will probably look unfamilar to most SEC staff as well, especially those higher in the hierarchy, whose vision is directed to the new, challenging, interesting, ground-breaking cases that are carefully built and are often vigorously litigated and appealed.[15]

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[14]Though perhaps bizarre, such an exercise would be fascinating, in my opinion, and in some ways considerably more "educational" than traditional presentations.

[15]In the context of another federal regulatory agency, the Cost of Living

Their blinders will exclude from their vision the typical violation quickly consented to by offenders because years of precedent and experience indicate that litigation will be pointless. It will exclude as well minor violations that never are formally prosecuted and therefore have little chance of inclusion in a casebook. To these observers, the work of the agency as reflected in these data will seem unfamilar and probably trivial. Indeed, one response to a preliminary report of research findings was that they were "wrong." They are not "wrong;" they are different and the difference derives from definitions of population and strategies of sampling.

The Coding Scheme and Coding Procedures

The examination of archival records of SEC investigations included in the sample generated two forms of data. One reflected the richness and depth of material available in the files, concerning patterns of illegality, kinds of offenders and victims, and patterns of investigatory technique, accumulated in pages of long-hand notes on the distinctive features of each particular case. The other reflected concern for standard information on each investigation which was amenable to quantitative analysis. This second data set required the development of a standard coding scheme which defined relevant variables and specified objective categories along which cases could be classified. The development and implementation of this coding scheme is the subject of this section.

Counsel, created to implement the nationwide wage-price freeze of 1971, Kagan makes a related observation. He notes that an examination of the top-level decisions, "generally the only ones reported and visible to those outside the agency," reveals a greater leniency, a tendency toward accomodation or change than the more stringent decisions of "the part of the bureaucratic iceberg that operates beneath the surface of public visibility." This pattern derives from the fact that "mechanisms of upward referral of cases tend to send up those cases with the strongest arguments for changes or riskier interpretations of existing rules" (1978, p. 162).

Because of the difficulty of gaining access to these archival records, because of the possibility that many of the older records would soon be destroyed, because the files were so disorganized that it was necessary to skim through most of their contents and digest a mass of complex material even to abstract a small bit of information, and because my initial theoretical interests were rather general and unspecified, the coding scheme was developed to gather as much information as possible. Specifically, it was designed to abstract information concerning characteristics of the offense, offenders, and victims, details of investigative technique including the circumstances under which the investigation was initiated, and details of case disposition.

The process of specifying relevant variables and categories involved the examination of treatises on securities law enforcement, other empirical work concerned with SEC enforcement and that of other regulatory agencies, consultation with law and social science professors and with SEC enforcement attorneys, and the examination of a number of SEC investigative records. A provisional coding scheme was developed and was pretested for about two months on a few dozen randomly/arbitrarily selected investigative files. The scheme was refined to benefit from the lessons learned during the pretest, and in mid-May, 1977 coding began on the research sample. Throughout coding, cards were made for phenomena which did not fit the code categories and, occasionally, new categories were added and previously coded cases were corrected to reflect the new categorization. In retrospect, some of the categorization could be improved. In a few instances, categories were too vague or failed to truly isolate or discriminate among cases. In more instances, the categories discriminated too much, either by generating greater detail than could be analyzed or requiring more detail than could usually be abstracted from archival materials. The opportunities for code refinement and correction, described

above, eliminated many of these problems. In any event, the quality of the scheme was rather high, especially for a first effort by anyone in this area, and the distinctions made were eminently useful, as subsequent analysis should demonstrate.

A copy of the final coding scheme is included in Appendix A. Two files of data were amassed, one which pertained to characteristics of the investigation itself, the other which pertained to each party investigated in the case.[16] Some information which aggregated offender characteristics was also noted in the case file. Slightly more than 200 variables concerning case related characteristics were coded as were about 130 variables concerning offender related characteristics.

As the coding scheme indicates, variables concerning characteristics of investigation include the dates upon which investigations were begun and completed, when docketed cases were opened or closed, when Formal Orders of Investigation were obtained, if at all, when intelligence inputs were received, and the sources of information about illegality. They included a checklist of sources of evidence potentially pursued during investigation, SEC regional offices involved in investigation, and an estimate of the magnitude of investigatory effort in terms of time and resources. They included estimates of the period of violation, a list of up to twenty-six different forms of alleged illegality investigated based upon a code of over one hundred offense categories, as well as notation of the SEC acts and statutes allegedly violated, notation of the means of violation employed, estimates of the amount of money involved in the offense, estimates of the numbers of victims of the offense, if any, and notation of their characteristics and relationship to the offenders.

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[16]Hence, 581 records of data were obtained for the case file, 2,319 records for the offender file.

Finally, case related variables indicated whether any of the alleged offenders were formally prosecuted and how so, justifications for prosecutorial choice, notations of ancillary remedies or informal or other social control remedies imposed.

The dataset on subjects of investigation included information on the type of party investigated and on the extent and nature of their recidivism. Where the subject was a person, data pertained to his or her social position, experience, age, and residence; where an organization, to its registered status with the SEC or other self-regulatory organizations, its structure, age, standard industry code, size, and region. For each offender, the forms of illegality in which it was alleged to have participated were recorded as were details of all forms of prosecution to which it was subjected, if any (dates, whether charges were litigated or consented to, final dispositions, sanctions, and appeals).

Of course, the fact that data were collected on these 330 variables does not say anything about the data so collected. Their quality is subject both to the possibility of missing or incomplete information and to inaccurate information. Where all information pertaining to a particular variable is missing from materials included in the file, that case was assigned a missing value score for that particular variable. Obviously, missing values are undesirable and pose significant data analytic problems, particularly when the proportion of missing values is high. However, a more serious problem derives from the possibility of partial or incomplete information. For example, the file might include materials indicative of a civil prosecution but not the criminal prosecution imposed as well. In this case, missing values would not be assigned (unless something in the file suggested that some relevant materials were missing) but rather the civil prosecution code would be assigned, which in

this case would be inaccurate.

There is no formal way to measure the quality of these data. The reader is reminded that the redundancy of records allowed some check of the accuracy of materials included in the files, and that there were common cues to the absence of materials that resulted in a search through other record systems or the assignment of missing value scores even where it may have been possible to assign questionable codes based on incomplete information. Two perspectives on variability in data quality are considered briefly, one which considers differences between variables, the other which considers differences between cases.

One indicator of variable quality is provided by an examination of the coding scheme in Appendix A, where the proportion of missing values is noted for each variable. Missing values were assigned either where information on a variable was unavailable or where available information appeared inaccurate or incomplete so that the assignment of a valid code was inappropriate. The extent of missing data, then is a gross indicator of the degree of attention to a particular phenomenon in the typical investigative file. Another sense for data quality is provided from a recounting of the experiences of the coder, which tells a similar tale. Generally, data quality is highest for phenomena pertaining directly to aspects of the investigatory and enforcement process. Variables pertaining to case disposition and the form of prosecution imposed and pertaining to the actual investigatory activities and their timing were of highest quality.[17] Variables pertaining to more remote kinds of information, for example, characteristics of offenders - age, recidivism, experience, corporate size - or of victims - their number, naivete, social class - were of

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[17]Missing data on these phenomena ranged from 0% to 12%, but were mostly less than 2%.

considerably lower reliability.[18] Those pertaining to phenomena more central to investigatory issues - the nature of illegality, the source of the investigation, informal dispositional remedies - were of moderate quality.[19] Finally, variables concerned with general processes and issues were more reliable than those that required specific information - amounts of money, numbers of victims, numbers of previous social control experiences, etc.[20]

However, these patterns of data quality do not necessarily hold uniformly across the sample. Cases that are formally prosecuted contain more and higher quality data than those that are not. The need to receive Commission authorization for prosecution results in the generation of special records and the explicit articulation of specific information that may otherwise be omitted from the investigatory materials. The greater attention to the accumulation of evidence where cases are prosecuted generally results in higher quality data as well. The fact of prosecution itself also generates record systems in the form of complaints, indictments, and releases that provide a recapitulation of the case that is more complete and orderly than that available when an unprosecuted investigation is closed.[21]

Not only does the fact of prosecution tend to generate more complete and

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[18]Missing data on these phenomena ranged from 0% to 53%.

[19]Missing data on these phenomena ranged from 0% to 12%.

[20]Missing data on specific information of this kind ranged from 14% to 37%.

[21]This notion that records are generated at different times in the sequence of investigation (for example, as a result of prosecution) reminds the reader that there is variability in data quality within cases as well as between cases, based upon the time in the sequence of investigation in which records are generated. Later records may be more accurate with respect to the matters being investigated but less accurate with respect to details of the investigatory process itself. It is impossible to control for all of these potential sources of bias uniformly across the sample. However, it is for that reason that the coder skimmed virtually all the materials in the file, constantly searching for and attempting to reconcile informational inconsistencies.

more accurate records, but so does the form of prosecution. Particular kinds of information are more salient to particular kinds of prosecution and hence greater attention to detail of those matters would be expected. For example, data on patterns of victimization were generally disappointing in terms of completeness and richness for the sample as a whole. However, where criminal prosecution is contemplated, victimization is a very important issue, since the ability to demonstrate significant harm to actual victims may be central both to the non-declination of the case by the Justice Department as well as to jury appeal. Therefore, in this instance, particular records pertaining to victimization may be developed, even if the records explicitly indicate the absence of substantial victimization, because of the centrality of this issue. Were administrative proceedings contemplated instead, it is very possible that such a record would never be developed because of its much lesser relevance in this context.

There are many less systematic sources of variability in data quality. The coder noted that some attorneys and some regional offices kept better records than others. There were no systematic patterns in data quality over time. Many old cases had incredibly complete files and some recent files were quite skimpy. Quality probably varies by the type of illegality investigated and the complexity and magnitude of the offense. Presumably, as the subject of investigation grows more complex, the matter of documenting the illegality and the investigatory process, of retaining and properly filing all of the records, becomes more difficult. However, it is also possible that investigations of this kind generate more redundant information which perhaps compensate for potential omissions.

In short, the matter of data quality is not a simple one. Quality varies according to the phenomenon about which data is being gathered, the timing in

the sequence of an investigation in which records are generated, the source and purpose of the records, the social location and assignment of the investigation, and the nature of the case with respect to complexity of the offense, magnitude of the investigation, and nature of its disposition. These sources of variability undoubtedly generate random and systematic biases in the data so varied that they cannot be easily sorted out. My response has been a cautious and skeptical interpretation of the data, and particular attention to data reliability for variables especially central to the analysis. That, for example, is the purpose of the last section of this chapter. However, I must stress that this skepticism and critical attention to data reliability should not mislead the reader into excessive distrust of what are some of the fullest, richest, and most complete materials upon which a data set of this kind could be built and of a coding process which was slow, methodical and conscientious.

Data collection continued for about seven months, from mid-May to late December, 1977. The full coding scheme had been developed before examination of investigative files included in the sample had begun, so it was possible to assign codes during their examination. Forms, copies of which are included in Appendix B, were developed to record all assigned codes, to assure that data on all variables would be collected, and to mininize the need to note potentially identifying information that might violate the access agreement. In addition to recording numerical codes on these forms, long hand notes concerning distinctive features of the case, detailing the nature of the illegality, and enriching the coded material were kept, and cards were made for each variable in which codes were inappropriate or problematic.

As noted earlier, investigative files sometimes contained thousands of pages of material, and the coder skimmed through all their contents. Furthermore, the contents of files were sometimes ordered randomly, without

consideration for chronology, type of document, purpose of document, or any other criterion. Hence, examination of files was often a confusing process, necessitating reassembling materials and skipping back and forth. Anywhere from about ten minutes to ten hours were allocated to the examination and coding of a case. However, the median amount of time allocated per case was between one and one and a half hours.

I was the only person to assemble, examine, or code any of the cases included in the pretest and sample. This fact has the weakness that the data are very much the reflection of the biases, perspectives, and misunderstandings of a single individual. It has the virtue, though, of relative consistency across the cases. Coding did not begin until an extensive pretest had been conducted, the scheme had been refined, and I had become very familiar with its categories and distinctions. Undoubtedly, however, over the period of seven months, I became more sophisticated, categories took on slightly different meanings, and I developed a clearer sense of the distinctive features of particular kinds of cases, all potentially reflected in coding assignments. This process is unavoidable. However, as noted earlier, the cases were coded in random order, so that any biases generated by this process were presumably randomly distributed.[22] After all data collection was completed, I reread the entire collection of codes, notes, and documents generated by this process to search for any patterns and inconsistencies that would reflect either error or changes in perspective or interpretation. Surprisingly few problems were discovered by this process.[23]

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[22]The date on which cases were coded was recorded. It is therefore possible that critical variables could be run against date coded and checked for any systematic patterns. This has not been done. However, I would not expect any significant findings, in part because of the small number of cases relative to the large number of possible codes.

[23]It would probably have been a better check if a random sample of cases was

The Source of Investigation: Particular Methodological Issues

This chapter has been oriented to general features of research design and execution. This last section is more particularistic. Only one element in the constellation of variables described above is considered. That variable, pertaining to the source of investigation, serves as the basis of most of the dissertation analysis. Therefore, closer attention to this variable - the circumstances of its construction and its overall quality - is appropriate.

"Source of Investigation" is recorded by #11 in the coding scheme. Code categories and the extent of missing data are indicated in Appendix A. We recall the discussion in the section on the research population of the presence of suspicions or allegations of illegality as the least common denominator of an investigation. Source variables record the social location in and circumstances under which these allegations develop. Allegations may emanate from sources outside of the SEC - from investors, insiders, members of the professional securities community, informants, federal or state agencies, or self-regulatory organzations. Or suspicions may develop in-house, in the course of broker-dealer inspections, the registration of securties offerings or securities professionals, or by market or other surveillance conducted by SEC personnel.[24] This variable had about seventy categories to reflect these diverse possibilities. And more than one allegation or suspicion may preceed the institution of an investigation. The source of each allegation was recorded as well as the date on which it came to the attention of the SEC. Up to six

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simply recoded, much like the keypunch verification process. This would have been very cumbersome. The total number of files included in the sample probably occupied several thousand cubic feet, and hence, since coding was done in a shared office, records could not be retained until data collection was completed. Records were stored in the Federal Records Center in Maryland and trucked in to the office. It would have been unreasonable to rerequest these files a second time.

[24] A detailed discussion of these varied sources is the subject of Chapter 5.

sources were coded; where more than this number of sources preceded investigation (found in only a handful of cases), the seventh and subsequent sources in chronological order were noted, but not coded. Only allegations which preceded investigation were recorded. This policy was adopted for two reasons: (1) to isolate those sources of intelligence which account for the decision to undertake investigation, and (2) to eliminate those allegations that result from rather than account for investigation (for example, those investors who complain about their victimization only after they read about the investigation in the Wall Street Journal).

The following discussion considers two issues pertaining to investigative source: (1) the reliability of this measure and problems of missing data, and (2) the impact of the definition of the research population on analysis which utilizes this variable. The coding of information on the source of an investigation was one of the most difficult and tedious tasks of the data collection. That is because sometimes there was no explicit indication of source in investigative records. In many instances, the forms which formally opened the case would explicitly state the source of investigation, or memoranda requesting Commission authorization of a Formal Order of Investigation or other memoranda or documents would provide this information, for example:

> "Investigation was initiated on January 2, 1970, after receiving a letter from John Doe from Seattle, who indicated that his stockbroker was embezzling funds from his account."

But often such explicit attribution of investigative source would be absent, and it was necessary to skim through the file, and through letters, memoranda, or other documents, to reconstruct the circumstances under which the investigation began. For example, the earliest document in the file may be a letter dated December 29, 1969 from John Doe to the SEC, followed by a memorandum from a

regional administrator to one of his attorneys to follow-up on the allegations contained in the letter.

Of course, whether the determination of investigative source is based on direct attribution or reconstruction and inference, it is subject to inaccuracy. It is possible that John Doe, or any other investor, for that matter, were not sources at all. More likely, though, inaccuracy derives from the fact that John Doe was not the first source. Jane Smith, or perhaps the president of the brokerage firm wrote a letter to the same effect two weeks earlier, and the records failed to record this fact. The most significant reliability problem, then, derives from incomplete or missing records, rather than from inaccurate ones. The outcome is the inability to code investigative source at all or the possibility, that where sources are multiple, that one or more of them may not be recorded. Both outcomes result in the inability to fully characterize the conditions under which investigation is instituted; the latter outcome can also mean distortions in the chronological ordering of multiple sources, and the like.

Where data of this kind were missing from the files or seemed to be clearly subject to inaccuracy, a missing value code was assigned. Where such data were present, I took great pains to evaluate their completeness. Because record systems are often redundant, the overlaps were searched for possible inconsistencies. The materials were scoured for any record that might disconfirm the reconstruction of events reflected in the code assigned, or for any date that might suggest that suspicions were present prior to the first source coded. The coding of this variable assumed the proportions of a second-rate detective story. The amount of effort allocated to the creation of this measure is probably not at all apparent. In any event, whenever there were doubts about the reliability of the reconstruction of events, a missing value

code was assigned, even if an alternative code was available.

Given the considerable difficulty in constructing this measure, the cautiousness of the coder, coupled with the fact that investigative source is not a critical piece of information to SEC enforcers, it is heartening that only 72 cases (12% of the sample) were assigned missing values on this variable. Since these cases will necessarily be excluded from all analysis concerned with investigative source, it is necessary to consider briefly those characteristics that distinguish them from cases which were assigned valid codes.

The best predictors of missing data on investigative source are bureaucratic/procedural rather than substantive issues. For example, among cases whose investigative files were missing and data were obtained from supplementary sources, 40% were assigned missing value codes on investigative source in contrast to 8% of the rest of sample. There are differences in rates of missing values by regional office as well, suggesting that some offices keep clearer, fuller, more complete records than others (a sense I got strongly from the experience of data collection). For example, rates of missing data in Ft. Worth and Boston were 4% in contrast to a rate of 34% in San Franscisco. Although one might have expected record quality to improve over time, reflected in decreasing rates of missing data, this was not the case. The amount of missing data was unrelated to date of investigation. There was only one significant substantive pattern of missing data. Where offenses solely involved violations of agency technical regulations, it was rather easy to determine the source of investigation (usually deriving from disclosure or inspection). As a result, only one of the eighty cases that fit this description was assigned a missing value in contrast to 14% of the remainder of the sample. There were no significant correlations of missing values with other substantive characteristics of an illegality or its investigation. Hence, the exclusion of

these cases with missing values on investigative source should not appreciably bias the analysis.

The second matter to be explored concerns the implications for analysis of the composition of the research population. The reader should recall the earlier discussion of over- and under-representation of investigative activities. Both have implications for the analysis of sources of investigation. Over-representation is relevant to the extent that multiple docketed cases are generated for which investigative source is an inappropriate consideration; under-representation is so because of the possibility that rates of exclusion from the population may vary by investigative source. Each matter is considered in turn.

In the discussion of multiple docketing, a variety of situations in which one docketed investigation would be related to others were described. Here only one of these situations is relevant: that in which a single docketed investigation gives rise to the docketing of one or more new cases. The "source" of these new cases, then, is the previous investigation. Now, where the newly docketed case was opened to explore suspicions of unrelated violations uncovered in the previous investigation, this relationship between cases is appropriate. The strategy of generating the new case is labeled the "spin-off." But often new cases are generated for bureaucratic expediency. The new cases may involve no investigative activity at all and the offenses alleged may be identical to those investigated in the parent case. In this instance, it was probably inappropriate to open a new case at all. But certainly the designation of the previous case as investigative source would be misleading. The source of this case is, in truth, not the original case, but the source of the original case; it is only bureaucratic accident that it must be reckoned with at all. Of course, the boundaries that separate an appropriate "spin-off" case and an

inappropriate duplicate case are ambiguous. What if the new case does involve investigative activity, but of the same allegations? What if the allegations are slightly different? Nonetheless, where cases clearly fall in the category of bureaucratic duplication, they have no place in the analysis of investigative source and are excluded from analysis. There were 37 (6%) cases of this kind in the sample.

Issues inherent in under-representation are more significant. On the basis of proxy measures and conjecture, it was suggested in that section that rates of exclusion from the population were related to the social location in and social circumstances under which suspicions of illegality develop. The precise data on which inferences were based are presented in Table 2.6. Unfortunately, the table is less than meaningful, since the labels applied to source of investigation are at this point, still somewhat mysterious to the reader. They are described in great detail in Chapter 5. Nonetheless, the table suggests that there are significant differences in these two proxy measures by investigative source. Investigations instituted in response to allegations by "insiders" in illegality, for example, are much more likely to be docketed immediately without preliminary investigation (83% versus 62%) and quickly (63% versus 28%) than those based on allegations by "investors." These are proxy measures,[25] utilized for the speculation that the longer it takes to docket an investigation, whether by first subjecting it to a preliminary investigation, or whether simply by delay, the greater the possibility that the investigation will be excluded from the population by being terminated without formal docketing. This is only a speculation, but if true, these data suggest that investigations based on allegations by insiders may be over-represented and those based on

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[25] Furthermore, these findings are based only on those investigations that ultimately did enter the population. Were it possible to consider the excluded cases, these findings might be rather different.

TABLE 2.6: DIFFERENCES IN DOCKETING BY SOURCE OF INVESTIGATION

Source of Investigation	Preliminary Investigation Before Docketing		Interval Before Docketing	
	% No	(N)*	% Less Than 1-1/2 Months	(N)*
Insiders	83%	(18)	63%	(41)
Incursions	80%	(89)	49%	(165)
Other Social Control	81%	(73)	41%	(143)
Securities Community	79%	(28)	36%	(56)
Surveillance	69%	(26)	30%	(57)
Investors	62%	(78)	28%	(117)
Total	78%	(268)	44%	(494)

*The N's are so different, because the analysis of preliminary investigation is based on the period prior to 1963, when this designation was abandoned.

surveillance or allegations by investors may be under-represented in the population of docketed cases.

The previous section of this chapter also presented the conjectures that the social context in which suspicions develop may be related to rates of under-representation or exclusion. Specifically, allegations referred by parties outside of the agency were perceived as more likely to be docketed than suspicions that arose in the context of normal regulatory activity. To the extent that these speculations are true, it is possible that investigative activities that begin as regulatory matters - for example, inspection, registration, and disclosure - are also under-represented in the population.

These observations serve to reinforce the obvious: the research sample is a sample of docketed investigations, not a sample of investigative sources. The likelihood that the allegations generated by a source are docketed may depend upon the presence of other social control remedies outside of formal investigation available, the "trustworthiness" of particular kinds of sources and the likelihood that their allegations are true and significant, the numbers of allegations generated by particular types of sources, and so on. In short, to the extent that the pool of sources reflected in docketed investigations is a biased sample of the population of sources - and we have every reason to believe that it is - the inferences made about investigative source and the hypotheses tested concerning them must be cautious indeed.

Conclusion

The introduction to this chapter promised to educate the reader about the problems and dilemmas of designing and executing research concerning the enforcement activities of a federal regulatory agency and to run through the series of parameters central to an assessment of the trustworthiness of the research. These topics have all been addressed. I do not know whether the

promise has been kept, either with respect to the content or the balance of these topics. Nonetheless, the reader should have a rather good feel for the research and its limitations which should permit him or her both to critically appraise the content of the following analysis and to conduct even better research in the future.

As this chapter introduced the reader to the research method, the following two chapters provide an introduction to the research setting. They consider the organization of the SEC, its enforcement work, and the nature of illegality investigators encounter. Chapter 5 then continues the examination of investigative source by describing in detail the conditions under which suspicions of illegality develop and result in SEC investigation.

CHAPTER 3: INTRODUCING THE SEC AND ITS ENFORCEMENT WORK

The setting of this research is the United States Securities and Exchange Commission (SEC). Unfortunately, a complete history of the SEC has never been written. The literature contains histories of the stock exchanges (Sobel 1973, 1975) as well as of the securities markets during particular periods (Percora 1939, Cormier 1962, Brooks 1958, 1969, 1973, Sobel 1968, 1977). It contains monographs on stock brokers (Baruch 1971), on public accountants (Briloff 1972, 1976), on particular securites swindlers, swindles, or SEC cases (Jones 1938, Miller 1965, Raw 1971, Tobias 1971, Patrick 1972, Kwitny 1973, Dirks and Gross 1974, Hutchison 1974, Dunn 1975, Soble and Dallos 1975, McCloy 1975, McClintick 1977, Maxa 1977, Shaplen 1978), even an autobiography of a Commissioner during his SEC days (Douglas 1940). But the most current history of the SEC pertains to the New Deal period (De Bedts 1964), the period in which the agency was created.

This dearth of literature on the history of the SEC is lamentable, both for purposes of this research and for the education of the general public. Nonetheless, this dissertation is not the occasion to write that history. Even the inherent historical quality of the archival data presented in the dissertation, reflecting investigations conducted over a twenty-five year period, has been deemphasized. That is so, in part, because the absence of a good SEC history makes it difficult to interpret a longitudinal analysis of these data, in part, because the small sample size precludes the fine distinctions that a longitudinal analysis requires. This chapter provides only the barest skeleton of a history of the SEC, focussing primarily on its structure and organization and particularly on its enforcement apparatus. Chapter 4 introduces the targets of SEC enforcement activity and the nature of

the offenses, offenders, and victims encountered by SEC investigators.

A Brief History of Securities Regulation

On the eve of the passage of the first federal securities legislation, the securities markets were in quite a sorry state. During the 1920's, securities on the exchanges had been subjected to considerable manipulation; bear raiders had attacked the markets with short sales in order to accentuate price declines. The exchanges took little self-regulatory initiative. New issues of corporate securities were being placed in only nominal amounts, trading on the exchanges was light. Investor confidence was at a low ebb. The following passage from a Congressional report characterizes the state of the markets in this period.

> During the post war decade some 50 billion of new securities were floated in the United States. Fully half or 25 billion worth of securities floated during this period have proven to be worthless. These cold figures spell tragedy in the lives of thousands of individuals who invested their life savings, accumulated after years of effort, in these worthless securities. The flotation of such a mass of essentially fraudulent securities was made possible because of the complete abandonment by many underwriters and dealers in securities of those standards of fair, honest, and prudent dealing that should be basic to the encouragement in investment in any enterprise. Alluring promises of easy wealth were freely made with little or no attempt to bring to the investors' attention those facts essential to estimating the worth of any security. (H.R. Rep. No. 85, 73rd Cong., 1st Sess. (1933) from Gadsby 1959, p. 9).

Although the stock market crash of October, 1929 and the subsequent depression spearheaded the drive for the development of a scheme of federal securities regulation, legislative activities toward this end had been underway for about fifty years.[1] Beginning with Kansas in 1911, state legislatures passed so-called "blue-sky" laws[2] to regulate intra-state securities. These

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[1]This discussion is based primarily on Gadsby 1959, Loss 1951, and Robbins 1966.

[2]They were called "blue-sky" laws because it was asserted that many speculative

laws contained either anti-fraud provisions, requirements for the registration of certain persons in the securities business, or for the registration or licensing of securities. By 1933, every state but Nevada had taken some legislative action. These local statutes proved to be inadequate because of their wide variations between the states and because state authorities were unable to cope with interstate activities of securities manipulators and promoters.

On the federal level, the regulatory theme was two-fold, attempts at federal incorporation or licensing and attempts at capital control. Since 1885, various Presidents, Congressmen, and public leaders had attempted to secure legislation that would require federal incorporation or licensing of corporations engaged in interstate commerce. From 1903, with the creation of the Bureau of Corporations in the new Department of Commerce and Labor, proposals were made annually for federal corporate licensing. But none of these proposals and efforts were ever implemented.

In the area of regulation of the capital markets, efforts were not any more successful. In 1912, the Pujo investigation of the money trust was initiated, leading to a recommendation to strengthen the stock exchanges, but no legislation followed. In 1918, as part of the war effort, the Capital Issues Committee was created to monitor the flow of capital in accordance with war needs. When it was abolished after the war, the Committee recommended the federal supervision of securties issues to halt the traffic in doubtful securities. Its recommendations were not heeded. Perhaps the most significant offshoot of the First World War was the widespread dissemination of Liberty Bonds and the concept that a piece of paper could represent property value. This development, on the one hand, made the public much more securities

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securities schemes have no more basis than so many feet of blue sky.

conscious, and on the other hand, created new opportunities for securities switching and other forms of abuse.

After the War, several bills were introduced in Congress to regulate the issuance and trading in securities. "But with securities markets booming, with credit easily available, and with rags to riches the theme of the day, legislators found little public support for such legislation" (Gadsby 1959, p. 7). Unfortunately, the stock market crash and the depression that followed were needed to dramatize the need for reform. In March, 1932, the Senate passed a resolution calling for an investigation, primarily of short selling, by its Committee on Banking and Currency. What resulted was a zealous probe directed by Ferdinand Pecora, which paved the way for the passage of the 1933 Securities Act.[3]

Following his election in 1932, Franklin Roosevelt assigned the task of developing securities legislation to a former Pujo investigator, Samuel Untermeyer. Several drafts and draftsmen (including Huston Thompson, Felix Frankfurter, James Landis, Benjamin Cohen, and Thomas Corcoran) and considerable Congressional debate later, the Securities Act became effective in mid-1933, with its administration entrusted to the Federal Trade Commission.[4] The Securities and Exchange Commission was created by Section 4 of the Securities Exchange Act of 1934, and on July 1, 1934, it took over the administration of both the 1933 and 1934 Acts. Both Securities Acts were considered important pieces of New Deal legislation and were hotly debated and firmly opposed by bankers and members of the securities industry (Miller 1979b, p. D1).

The Securities and Exchange Commission consists of five Commissioners,

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[3]For a fascinating account, see Pecora 1939.

[4]For an excellent discussion of the legislative history of the 1933 Act as well as the history of American securities regulation generally, see Parrish 1970.

appointed by the President with the advice and consent of the Senate. They serve five year terms, staggered so that one appointment expires each year. Not more than three Commissioners can be of the same political party and there is an attempt to stagger appointments by party. Until 1950, the Chairman was elected annually by the Commissioners. Since that time, he has been designated by the President and delegated additional executive and administrative responsibilities.

The Commission is an independent regulatory agency. It submits requests for appropriations and legislative proposals to the Executive Branch. It is subject to the oversight of the Interstate and Foreign Commerce Committee of the House of Representatives and of the Committee on Banking and Currency of the Senate. The Commission must submit an annual report to Congress and is subject to additional Congressional investigation or inquiry on occasion. The Commission is otherwise independent and immune from executive or legislative intervention in the exercise of its responsibilities (Orrick 1959, p. 53).

A Brief History of the SEC

I have already suggested that a complete up-to-date history of the SEC does not exist. There is some literature on regulatory agency development generally. A well-known essay by Marver Bernstein (1955) introduces the notion of agency life-cycles, reflected in periods of "Gestation," "Youth," "The Process of Devitalization," and "Debility and Decline" (1955, pp. 75-99), a developmental process which certainly characterizes other organizations as well.[5] There have been a few attempts by writers of the SEC to squeeze the agency into this mold, but the efforts have been rather unconvincing (Robbins 1966, pp. 73-5, Sobel 1977, p. 173).

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[5]See, for example, Weber 1947, Michels 1948, Messenger 1955, Stinchcombe 1965. This notion was also introduced by Galbraith 1955, p. 171.

The following discussion runs through some of the important developments and significant Commissions in the agency's forty-five year history. It is based heavily on a chapter by Robert Sobel (1977, pp. 164-192), a prolific historian of the securities markets.[6] His is a rather critical view of the agency and its Chairmen, but hopefully the account is accurate in the historical portraits it conveys.

When Franklin Roosevelt assumed the Presidency in 1933, Wall Street had become the scapegoat for the nation's economic demise, and the public clamored for action. "Of all the New Deal agencies created in Franklin Roosevelt's first term, none began life with more publicity, interest, and glamour than did the SEC. In these respects it could be compared to the congressional committees investigating Watergate corruption and considering impeachment" (Sobel 1977, p. 166). This image was not to remain with the agency through much of its subsequent history.

Roosevelt appointed Joseph Kennedy as first Chairman of the SEC. He was a former speculator and only a year before had engaged in conduct later outlawed by the 1934 Securities Exchange Act. The rationale was that Kennedy would be a wolf out to catch other wolves, and at the same time would be an insider who could work with Wall Street's "Old Guard." (Sobel 1977, pp. 167-8). Kennedy was followed in the chairmanship by James Landis, one of the architects of the securities legislation and a former Harvard law professor. Like Kennedy, he did little to reform Wall street, and his inaction led to the resignation of most of the SEC's "young firebrands." (Sobel 1977, p. 168)

Landis was followed by William O. Douglas, another liberal law professor. Like that of his predecessors, the agency Douglas chaired lacked money, staff, and the clout to make significant changes on Wall Street. The main developments

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[6]See also Sobel 1965, 1968, 1973 and 1975.

in the market during this chairmanship resulted from external events: the scandal resulting from the indictment of former New York Stock Exchange (N.Y.S.E.) President Richard Whitney for misappropriation of securities and a sharp collapse of the stock market in 1936. The former resulted in a reform of the N.Y.S.E., the latter in little securities activities left to regulate.

When Douglas was appointed to the U.S. Supreme Court, he was replaced by Jerome Frank whose reform efforts were also frustrated. Frank resigned within two years to take a seat on the federal bench and was quickly succeeded by Edward Eicher and Ganson Purcell. Purcell had risen through the ranks of the SEC and was considered one of the ablest men on the Commission (Sobel 1977, p. 170). Purcell served in an era in which the SEC faded from public view and came to be perceived as rather impotent. In 1942, Commission Headquarters were moved to Philadelphia so that their Washington Offices could be used for more vital defense work associated with the Second World War. Although the Commission could have returned to Washington in 1946, the White House felt that relocation was not worth the effort. When it did relocate in 1947, the event was barely noticed. Indeed, in 1950 the New York World Telegram and Sun joked: "The SEC may be moved from Washington back to Philadelphia. Its slumber will be as profound in one place as in another." (Sobel 1977, p. 171).

Purcell was replaced by James Caffrey and then Edmund Hanrahan. Both men left little mark on the financial district, were noteworthy in their silence and invisibility. Between 1952 and 1955, the Chairmanship reflected four different Eisenhower appointments: Harry McDonald, Donald Cook, Ralph Demmler, and J. Sinclair Armstrong, all of them able men but "largely ineffectual due to low budgets and White House disinterest. ... The Commission had only 770 employees by 1954, and all but a handful of them were clerks, typists, political appointees, rejects from other agencies, time servers, and ambitious young men

who hoped to use their employment as a means whereby they could land more worthwhile positions in the financial district." (Sobel 1977, p. 172). Edward Gadsby succeeded Armstrong in 1957. Through realism and political experience, Gadsby was able to get higher appropriations for the agency, but they were still insufficient. Meanwhile, through this period of ineffectiveness and inactivity, widespread abuses were brewing unchecked in the securities markets, eventuating in a massive scandal at the American Stock Exchange.

John Kennedy was elected President in 1960, and immediately asked former SEC Chairman Landis to prepare a report on regulatory agencies. As a result of the problems described in the report, Kennedy requested and Congress approved the preparation of a "Special Study of the Securities Markets," completed in 1963, the first comprehensive study of the securities markets since the New Deal. In response to the study, the 1964 Securities Act Amendments were passed, deemphasizing self-regulation and creating new regulatory powers for the SEC. Along with creating legislative resources, the Commission was given considerably increased resources in staff and appropriations.

Kennedy's first SEC Chairman was William Cary, a former law professor who had been critical of the SEC. He did much to reinvigorate the agency, and during his tenure some of the brightest minds in Washington joined the staff, worked on the Special Study, and stayed on. Cary was a very visible and vocal spokesman for the agency. But his activities fell far short of the many reforms inherent in the conclusions of the Special Study.

On the eve of Tino DeAngelis' famous "salad oil swindle," John Kennedy was assassinated and a more disinterested Lyndon Johnson took over the Presidency. Nine months later, Cary resigned and was replaced by Manuel Cohen. Cohen saw problems developing in the back offices of the broker-dealer firms and with the failure of exchanges to automate, but the White House under Johnson was not

interested in an anti-Wall Street crusade (Sobel 1977, p. 176). Cohen attempted to effect changes, but was unable to get support from either the White House or Wall Street. Many of the activist SEC staff began to leave the Commission. As the nation was about to undergo the greatest economic decline since the Depression, the SEC was again weak and almost powerless (Sobel 1977, p. 177).

Nixon's first Chairman was Hamer Budge, appointed during a period when the traditional market machinery was breaking down and the Third Market[7] loomed in the foreground. Sobel argues that Budge basically lost control of his agency (a problem of political appointees occurring elsewhere in the Nixon administration as well) and staffers struck out to reform the market structure without Budge's initiative or direction (1977, p. 179). Under the criticism of his staff and Congress, Budge eventually resigned in 1971. He was replaced by William J. Casey, a businessman-speculator-lawyer, and at the time, a contestant in a civil action for securities violations (Sobel 1977, p. 180). While his appointment was being debated, SEC staff were without leadership and continued to press for reform. Rather unexpectedly, Casey lashed out at Wall Street, called for a movement toward a centralized market, a halt to commission fixing, and pledged greater surveillance of the commission houses. He supported staff efforts at making the SEC an active regulatory agency, and asked the White House for supplemental appropriations for new staff and studies.

Casey was replaced in early 1973 by G. Bradford Cook, former General Counsel of the agency. His appointment lasted less than three months, when he was forced to resign because of his previous involvement in the Robert Vesco

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[7]The Third Market is the "nickname applied to over-the-counter or off-board trading in big blocks of listed securities. . . .It exists largely to service the needs of institutional investors and definitely not the man in the street" (Stabler 1965, p. 230).

affair when General Counsel. The SEC was without a permanent Chairman. Nixon was quite afflicted by Watergate by this time, and therefore selected a chairman who was beyond reproach. His choice was Ray Garrett, a former SEC employee with a fine reputation. The Garrett Commission was composed of a number of men with experience in securities matters, respected by the staff, and ready and able to take on the problems in the securities industry. "Under Garrett, the Commission was more vigorous and effective than it had been in more than a decade." (Sobel 1977, p. 184). With Nixon's weakness, the Commission by 1973-74 had moved from the executive to the Congressional sphere of influence. This new Commission worked more closely with Congress and secured passage of the 1975 Securities Act Amendments, designed to facilitate the movement to a central marketplace, and to expand SEC authority over the stock exchanges. The Commission ordered that exchanges could not restrain their members from trading over-the-counter. It organized the National Market Advisory Board to develop a plan for the central market. The SEC had become active, aggressive, and reborn (Sobel 1977, p. 185).

Concomitant with aggressiveness on the Wall Street front, the SEC also become aggressive with respect to securities issuers. During this period, the Enforcement Division, under the direction of Stanley Sporkin, began probes of many major American corporations with regard to national and international bribery, questionable payments, kickbacks, and management fraud. Over two hundred companies came forward with voluntary admissions of wrongdoing in hopes of forestalling further investigation or sanctions. Largely because of this enforcement work, Garrett asked for and received larger budgets and additional personnel, much of which went to the Division of Enforcement. In 1975, major amendments to the Securities Laws called for the creation of a national market system which links exchanges and market makers electronically, a system that will allow investors to make the best trades. The Amendments also abolished

broker fixed commission rates, which has strengthened the SEC's legal authority in the regulation of brokers and exchanges (Miller 1979b, p. D19).

In early 1976, Garrett was replaced by Roderick Hills, a labor lawyer and Ford appointee. Commission activities continued much as in the previous administration, if perhaps less feverishly, with a continued emphasis on enforcement and on the movement to a central market system. By the 1976 election, neither Wall Street nor the SEC was a campaign issue. In 1977, President Carter replaced Hills with Harold Williams, Dean of the Graduate School of Management at UCLA. Williams is regarded as more conservative than his predecessors (Miller 1979b, p. D1) and is reported to be less eager "to push forward the frontiers of SEC law enforcement in the future" (Miller 1979a, pp. D1, D13). Under his chairmanship, there has been some effort to reduce agency regulation, a move vigorously opposed by Division of Enforcement officials who feel that the Commission is emphasizing market efficiency at the expense of stockholder protection, actions that eroding investor safeguards (Miller 1979a, 1979b). Williams' full legacy at the Commission remains to be told, however.

On the occasion of the fiftieth anniversary of the New York Stock Exchange crash, Judith Miller (1976b) commented on the change in the SEC and in the securities markets over the years.

> This agency is watching a stock market that is vastly different from its 1929 counterpart. For one thing, the stock market's power over the economy has shriveled from the time when Wall Street was the epicenter of the world's free market. In 1929, the market was one of largely individual investors; today, large institutions account for half of the holdings on the Big Board and three-quarters of the trading activity. Private pension funds, for example, which held only $500 million worth of stock in 1929, today hold close to $200 billion.
>
> Today's equities market has fallen on hard times, with a defection, according to some estimates, of at least 7

> million shareholders since 1970 and a sharp decline in new equity issues. The key culprit is inflation, which has led investors to find refuge in real estate, commodities, art, foreign securities, stock options, futures contracts and other investment alternatives that appear to keep better pace with spiraling prices (Miller 1979b, p. D19).

Miller suggests that this malaise in the securities markets has generated a new skepticism toward the SEC, an agency that is at the crossroads (Miller 1979b, p. D19).

The Image of the SEC

Notwithstanding Sobel's portrait of a rather uneven record of agency performance and periodic episodes of lethargy or impotence, the SEC has carried throughout its history the reputation of the finest or one of the finest of the federal regulatory agencies. Among those who have contributed to this appraisal include an SEC Commissioner, who characterized the reputation of the Commission in the 1930's:

> ". . .when almost every young lawyer in the government wanted to be associated with the SEC or the Solicitor General's office - as the two best law offices in Washington." (Cary 1964, p. 661);

a law professor:

> "It has attracted, during the past thirty-seven years, as Commissioners and staff members, some of the ablest people to enter American public life. It has never been subject to any serious charges of impropriety or political influence, and it has probably the best reputation of any of the federal regulatory agencies, both in the business community and among disinterested observers." (Ratner 1971, p. 583);

> "Among lawyers, and among students of governmental process, the SEC generally enjoys a high reputation. It has been noteworthy for the level of intelligence and integrity of its staff, the flexibility and informality of many of its procedures, and its avoidance of the political and economic pitfalls in which many other regulatory agencies have found themselves trapped. Its disclosure and enforcement policies have also been credited with making an important contribution to the generally favorable reputation which

> American corporate securities and American securities markets enjoy, not only among American investors, but also in foreign countries." (Ratner 1978, pp. 2-3);

a reporter:

> ". . .the Securities and Exchange Commission, is still widely regarded as the nation's finest independent regulatory agency." (Miller 1979b, p. D1);

and a Congressional Subcommittee:

> "The Subcommittee has ranked the nine regulatory agencies under its jurisdiction by measuring various aspects of the performance of these agencies ... The nine agency chapters of this report are arranged according to this ranking, with the Securities and Exchange Commission placed first ... Criteria used in this ranking include the following aspects of agency performance: fidelity to public protection mandate defined by Congress; quantity and quality of agency activity; effectiveness of agency enforcement programs; and quality of public participation ... The Securities and Exchange Commission has maintained consistently vigorous enforcement efforts over the past several decades. It has attracted qualified leaders to the commission and to its staff. Its courageous handling of the ongoing investigation of illegal corporate payments is commendable. Its resistence to White House efforts to install politically favored employees should be a model for all agencies." (Subcommittee 1976, p. 11).

Ratner suggests that some of the success and repute of the Commission derives from the nature of the activity that it regulates. These pertain to: (1) the fact that the securities industry is not a monopoly situation, but open to an unlimited number of parties, and therefore the SEC is spared the task of choosing between competing applicants for a limited number of franchises, an activity which damages the reputation of other agencies; (2) the fact that the SEC has a "relatively well-defined, well-organized and manageable constituency;" (3) the limited role that the SEC has been assigned in regulating the securities business (it is not allowed, for example, to evaluate the merits of a particular security); and (4) perhaps most important, the general upward trend of the stock market during much of the agency's history, resulting in lesser dissatisfaction

with the agency from investors who have made substantial profits (1971, pp. 583-4). Implicit in this analysis are some hypotheses about agency structure and function and their relationship to reputation which are amenable to empirical test. To my knowledge, such a test has never been made in any regulatory context.

Let us turn, then, to consideration of the structure and organization of the SEC and especially its enforcement activities from which much of the agency's good reputation of late has derived. We begin with a slight detour, however, to review the full complement of securities legislation which the SEC is entrusted to administer, and around which the operational divisions of the agency are structured.

The Federal Securities Legislation

The Securities and Exchange Commission is charged with the administration of six laws, enacted between 1933 and 1940, pertaining to securities, finance, and protection of investors and the public in their securities transactions. The Commission also plays an advisory role under Chapter X of the National Bankruptcy Act.[8] These Acts have been amended several times, the most significant of which occurred in 1964 and 1975. The following descriptions briefly outline the provisions of these seven Acts. More detailed discussion of various statutes, rules and regulations, and exemptions are found in Chapter 4, where specific securities violations are described. The most important Acts from the perspective of SEC enforcement activities are the 1933 Securities Act and 1934 Securities Exchange Act.

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[8]The Securities Investor Protection Act of 1970, which does not directly involve the SEC, established the Securities Investor Protection Corporation (SIPC) which supervises the liquidation of securities firms in financial difficulty and the payment of claims to their customers.

The Securities Act of 1933

The objectives of this first piece of securities legislation are "(a) to provide investors with material financial and other information concerning securities offered for public sale; and (b) to prohibit misrepresentation, deceit and other fraudulent acts and practices in the sale of securities generally (whether or not required to register)" (The Work of the SEC 1974, p. 1). The first objective is pursued by the requirement that securities offered for public sale by an issuing company or by any person in a control relationship to the company be registered with the SEC. Such parties must file a registration statement disclosing material facts concerning the company and the securities it proposes to sell, so that investors can make an informed decision about whether or not to purchase the securities. Investors must be furnished with a prospectus containing information from the registration statement. Registration statements become effective on the twentieth day after being filed unless the Commission accelerates the date or issues a stop order which refuses or suspends effectiveness of the registration statement. Registration statements are examined for adequate and accurate disclosure by the Division of Corporate Finance which notifies registrants by deficiency letter of inadequacies in the statement, giving them the opportunity to amend the filings. The Division does not judge the merits of the offering, nor does it guarantee the accuracy of the facts presented. However, the Act proscribes false and misleading statements, provides sanctions for violations, and provides for recovery rights for investors who suffer a loss as a result of misrepresentations. During Fiscal 1977, 2,912 securities valued at 93 billion dollars were registered. A total of 56,367 securities have been registered since the creation of the SEC (Annual Report 1977, p. 317).

The Securities Exchange Act of 1934

This Act extends the disclosure doctrine to securities which are already issued and outstanding, whether listed on the national securities exchanges or traded over-the-counter. The Act contains a number of different provisions aimed at various parties in securities transactions. Companies whose securities are so traded must register with the Commission and the exchange (if appropriate) and file registration statements similar to, but less extensive than, 1933 Act registrations. These companies must subsequently file annual and other periodic reports with the Commission. Other provisions of the 1934 Act include the filing of proposed proxy materials by management or shareholders groups, disclosures by persons seeking to acquire over 5% (formerly 10%) of a company's shares, disclosures by persons soliciting shareholders to accept or reject tender offers, disclosures by officers, directors, and beneficial owners of more than 10% of its securities of their holdings and changes in holdings. The Act also regulates purchases and sales of company securities by these insiders.

The 1934 Act requires the registration of national securites exchanges and associations of broker-dealers, both of which must undertake self-regulatory measures, the registration of broker-dealers themselves, and periodic reporting by these parties. The business practices of registered broker-dealers are prescribed by the Act, which also authorizes Commission inspections of these firms and their books and records.[9] During 1976, 4,347 broker-dealer firms, comprising 200,000 employees, were registered with the Commission (Annual Report 1977, p. 286). The Act also contains provisions governing the use of credit in securities purchases (margin trading). Finally, it proscribes

[9]As a result of Congressional investigation of the operational and financial crisis between 1968 and 1970 in the securities industry, the 1975 Act amendments increase SEC authority over exchanges and the market system.

misrepresentations, deceit, market manipulation, and other fraudulent acts and practices, provides sanctions for these offenses, and stipulates rights of private recovery by victims of these abuses.

The Public Utility Holding Company Act of 1935

This Act was passed after an extensive investigation conducted by the Federal Trade Commission revealed a number of abuses in utility holding-company systems across the country. It requires the registration of interstate electric and gas public-utility holding-company systems and their filing of initial and periodic reports with the Commission. The major objective of this legislation was to integrate systems capable of economic operation within single regions or several contiguous states and to simplify corporate structures. Since its passage, about 2,500 companies have been subject to the Act as registered holding companies or subsidiaries. "Through extensive reorganizations, mergers, distributions, and exchanges of properties and securities, the bulk of utility companies no longer falls within the scope of the Act." (Robbins 1966, p. 14). By 1977, only 18 active holding companies systems were registered, comprising 161 companies (Annual Report 1977, p. 328). The SEC's functions under the Act were essentially completed by the 1950's and the Act accounts for a minority of the current work of the Commission.

The Trust Indenture Act of 1939

The Trust Indenture Act was passed after Commission studies of protective and reorganization committees revealed numerous abuses in which indenture trustees failed to protect the interests of the holders of indenture securities because of their divided loyalties between debtors and public investors. The Act requires that bonds, debentures, notes and other debt securities offered for public sale be issued according to the requirements of the Act and qualified

with the Commission. The provisions of the Act are similar to those of the 1933 Securities Act. The Act also "requires the indenture to specify the rights of the holders of securities, imposes high standards of conduct and responsibility upon the trustee, provides for the submission of reports by the trustee to security holders, and prohibits impairment of the individual security holder's right to sue for principal and interest except under certain circumstances" (Robbins 1966, p. 60). During fiscal year 1977, 358 trust indentures relating to securities aggregating 24.63 billion dollars were filed with the Commission (Annual Report 1977, p. 118).

The Investment Company Act of 1940

The Public Utility Holding Company Act of 1935 directed the Commission to undertake a study of the activities of investment companies and investment advisors. The Investment Company Act was passed as a result of the findings of this study.

> In addition to a requirement that such companies register with the Commission, the law requires disclosure of their financial condition and investment policies to afford investors full and complete information about their activities; prohibits such companies from changing the nature of their business or their investment policies without the approval of the stockholders; bars persons guilty of security frauds from serving as officers and directors; prevents underwriters, investment bankers or brokers from constituting more than a minority of the directors of such companies; requires management contracts (and material changes therein) to be submitted to security holders for their approval; prohibits transactions between such companies and their directors, officers, or affiliated companies or persons, except on approval by the Commission as being fair and involving no overreaching; forbids the issuance of senior securities by such companies except under specified conditions and upon specified terms; and prohibits pyramiding of such companies and cross-ownership of their securities. (The Work of the SEC 1974, p. 17).

The securities of investment companies must also be registered under the 1933

Securities Act, and companies must file periodic reports and comply with proxy and insider trading rules. As of September 30, 1977, 1333 active investment companies with assets of 77 billion dollars were registered with the Commission under this Act (Annual Report 1977, p. 304).

The Investment Advisors Act of 1940

The Investment Advisors Act is patterned after the broker-dealer registration provisions of the Securities Exchange Act of 1934. It requires the registration of persons or firms engaged in the business of furnishing investment advice for compensation and their compliance with statutory standards designed to protect investor interests. The Act requires that registered investment advisors maintain books and records according to Commission rules and authorizes Commission inspections. It also contains anti-fraud provisions, and empowers the Commission to adopt rules which define and prevent fraudulent, deceptive, or manipulative acts and practices. On September 30, 1977, 4,823 investment advisors were registered with the Commission (Annual Report 1977, p. 234).

Chapter X of the Bankruptcy Act

The Commission serves as advisor to the United States district courts under Chapter X of the National Bankruptcy Act in connection with proceedings for the reorganization of debtor corporations in which there is a substantial public interest. Of concern to the Commission in these proceedings are the qualifications and independence of trustees, fee allowances to the various parties, sales of properties and other assets, interim distributions to security holders, and the overall formulation of plans of reorganization of the corporation which are fair and equitable to the various creditors and other security holders and which will help assure that the corporation will emerge

from bankruptcy in sound financial condition. In cases in which the scheduled liabilities of the debtor exceed three million dollars, the plan of reorganization must be referred by the court to the Commission for an advisory report on the fairness and feasibility of the plan. In other cases, the plan may be referred to the Commission, whose views are stated orally. Most of these cases are handled by the SEC regional offices (The Work of the SEC 1974, pp. 18-19). During the fiscal year 1977, the Commission was a party to 124 reorganization proceedings (Annual Report 1977, p. 251).

The Organizational Structure of the SEC

About two-thirds of the SEC staff work in the Headquarters Office of the Commission (Ratner 1978, p. 3), located in Washington, D.C. throughout agency history with the exception of the 1942-47 move to Philadelphia. The other third work in nine regional offices - New York, Boston, Atlanta, Chicago, Ft. Worth, Denver, Los Angeles, Seattle, and Washington, D.C. - or eight branch offices.[10] Figure 3.1 lists the SEC regional and branch offices and demarcates them on a U.S. map. The character of the regional offices is described elsewhere in the dissertation.

Operational Divisions

In a recent "nutshell" on securities regulation, Ratner presents Commission estimates (uncited) that 34% of its staff are engaged in "fraud prevention," 27% in "disclosure," 25% in regulation of broker-dealers and the markets, 13% in regulation of investment companies and investment advisors, and 2% in public

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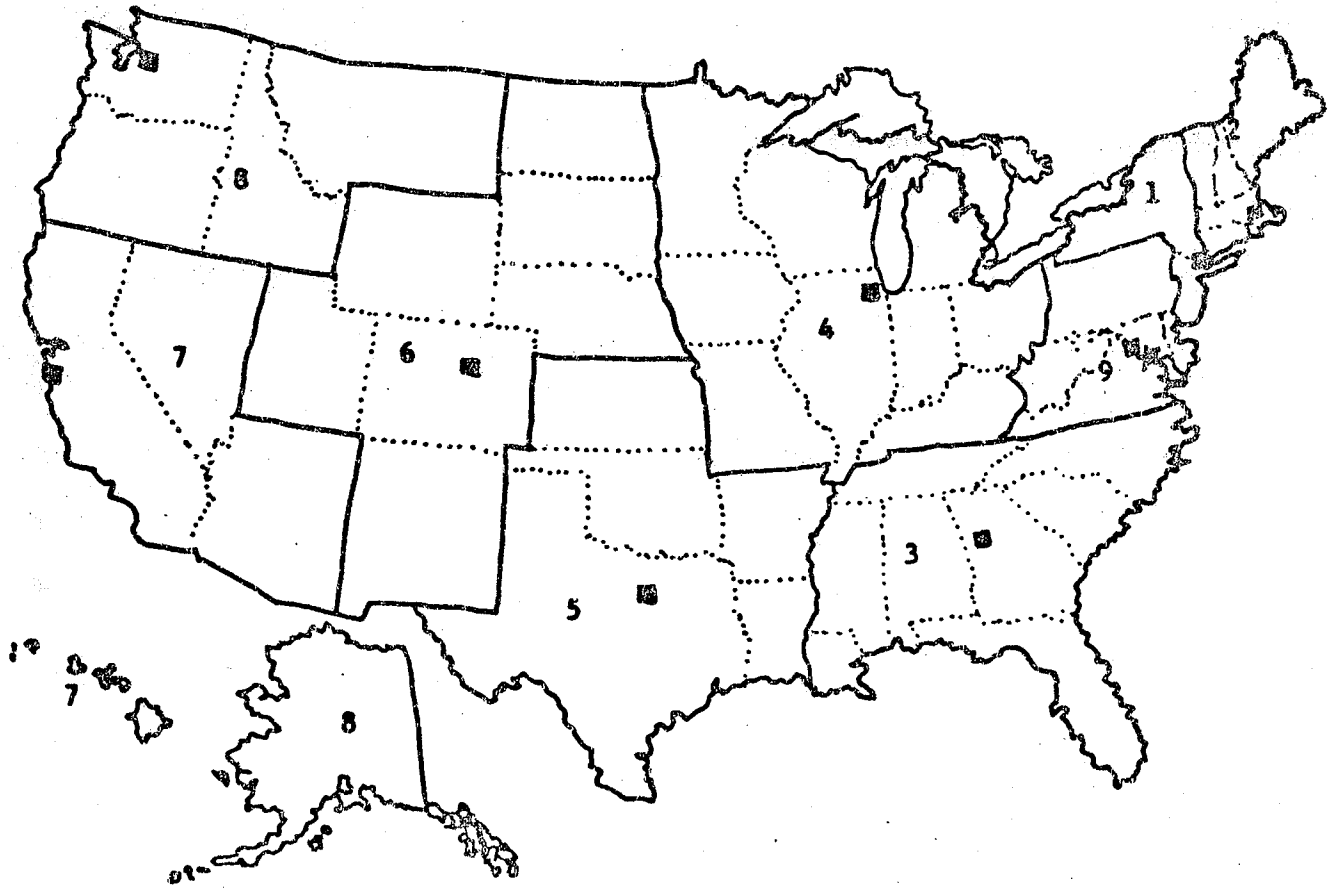
[10] Between 1940 and 1953, there was also a regional office in Cleveland. It subsequently became a branch of the Chicago office. Prior to 1972, the regional office in California was located in San Francisco rather than Los Angeles. The Philadelphia Branch Office was created in 1972. Washington, D.C. is a regional office, covering the District, Pennsylvania, Maryland, Delaware, Virginia, and West Virginia, not to be confused either with the Headquarters or the Seattle regional office.

FIGURE 3.1: THE SEC REGIONAL OFFICES

REGIONAL OFFICE								
1	2	3	4	5	6	7	8	9
NEW YORK REGIONAL OFFICE	BOSTON REGIONAL OFFICE	ATLANTA REGIONAL OFFICE	CHICAGO REGIONAL OFFICE	FORT WORTH REGIONAL OFFICE	DENVER REGIONAL OFFICE	SAN FRANCISCO REGIONAL OFFICE	SEATTLE REGIONAL OFFICE	WASHINGTON, D.C. REGIONAL OFFICE
		Miami, Fla. Branch	Cleveland, Ohio Branch Detroit, Mich. Branch St. Louis, Mo. Branch	Houston, Texas Branch	Salt Lake City, Utah Branch	Los Angeles, Calif. Branch		



utility holding company regulation (1978, p.3). There are no longitudinal data available on staff allocations, but undoubtedly there would be substantial variations in these proportions over agency history. The categories correspond more or less to SEC operational divisions. Figure 3.2 presents the organizational charts representing the present Commission structure (top) as well as Commission structure prior to a major Commission reorganization in 1972 (bottom). The bottom chart reflects agency structure (more or less) throughout most of the period reflected in the research. The major change is the creation after 1972 of a separate Division of Enforcement (more about this later) and the splitting of the Division of Trading and Markets into those of Market Regulation and Investment Management Regulation.[11]

In an article on the occasion of the twenty-fifth anniversary of the agency, Commissioner Anthony Orrick (1959) described the basic functions of the operating divisions of the SEC. The article is dated, of course, but since it was written within two years of the mean date of investigation of the research sample, it perhaps best characterizes the "agency" that is the subject of this research. The Division of Corporate Finance is staffed by accountants, examiners, and attorneys. It is responsible for the processing and examination of all registration statements under the 1933 Act, the processing of all proxy soliciting material, the processing of corporate annual, semiannual, and periodic reports required by the 1934 Act, the provision of interpretive services to potential and actual securities issuers, and the coordination with SEC regional offices of offerings under the small issues exemption (Reg A).

The Division of Corporate Regulation has three branches. The Branch of

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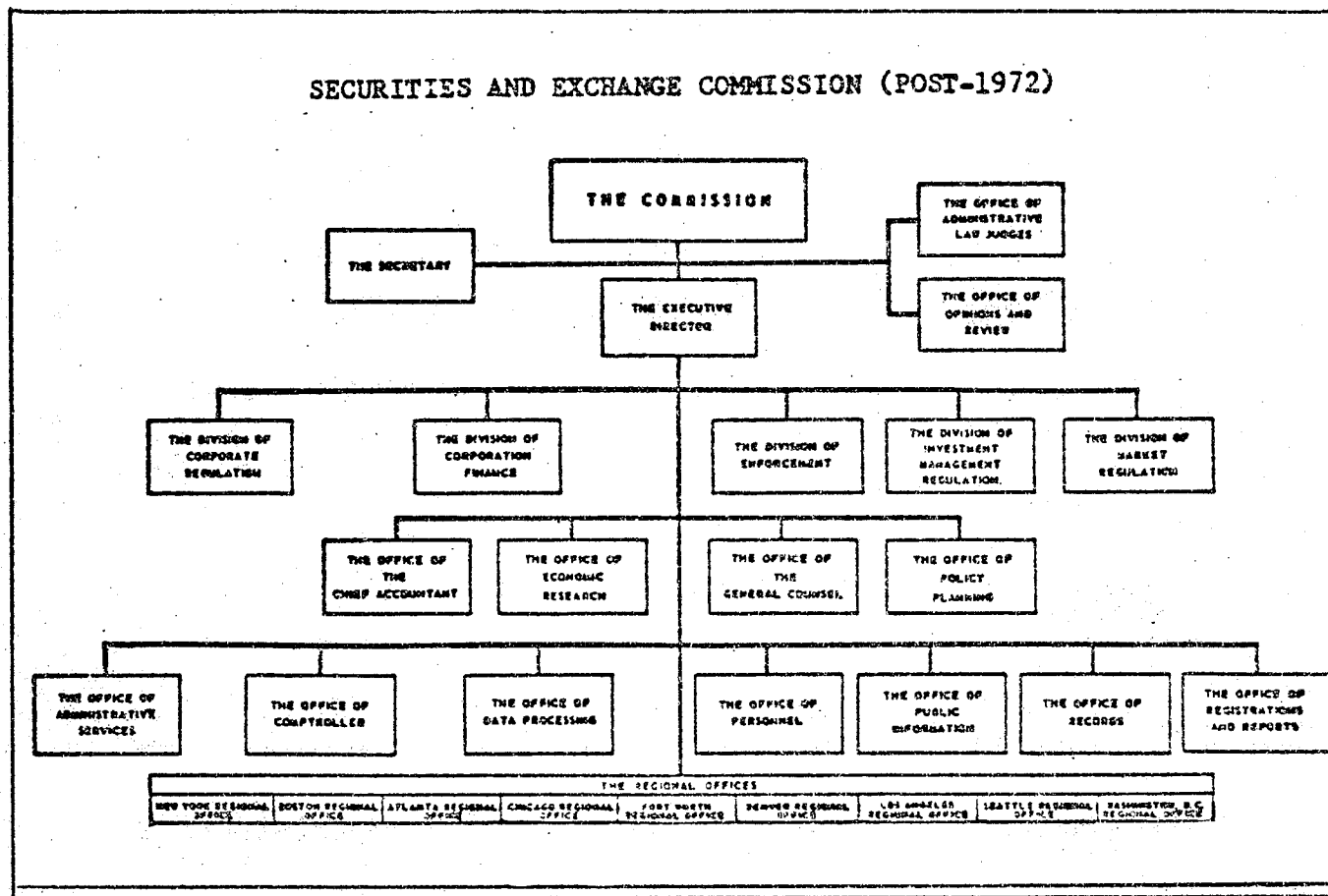
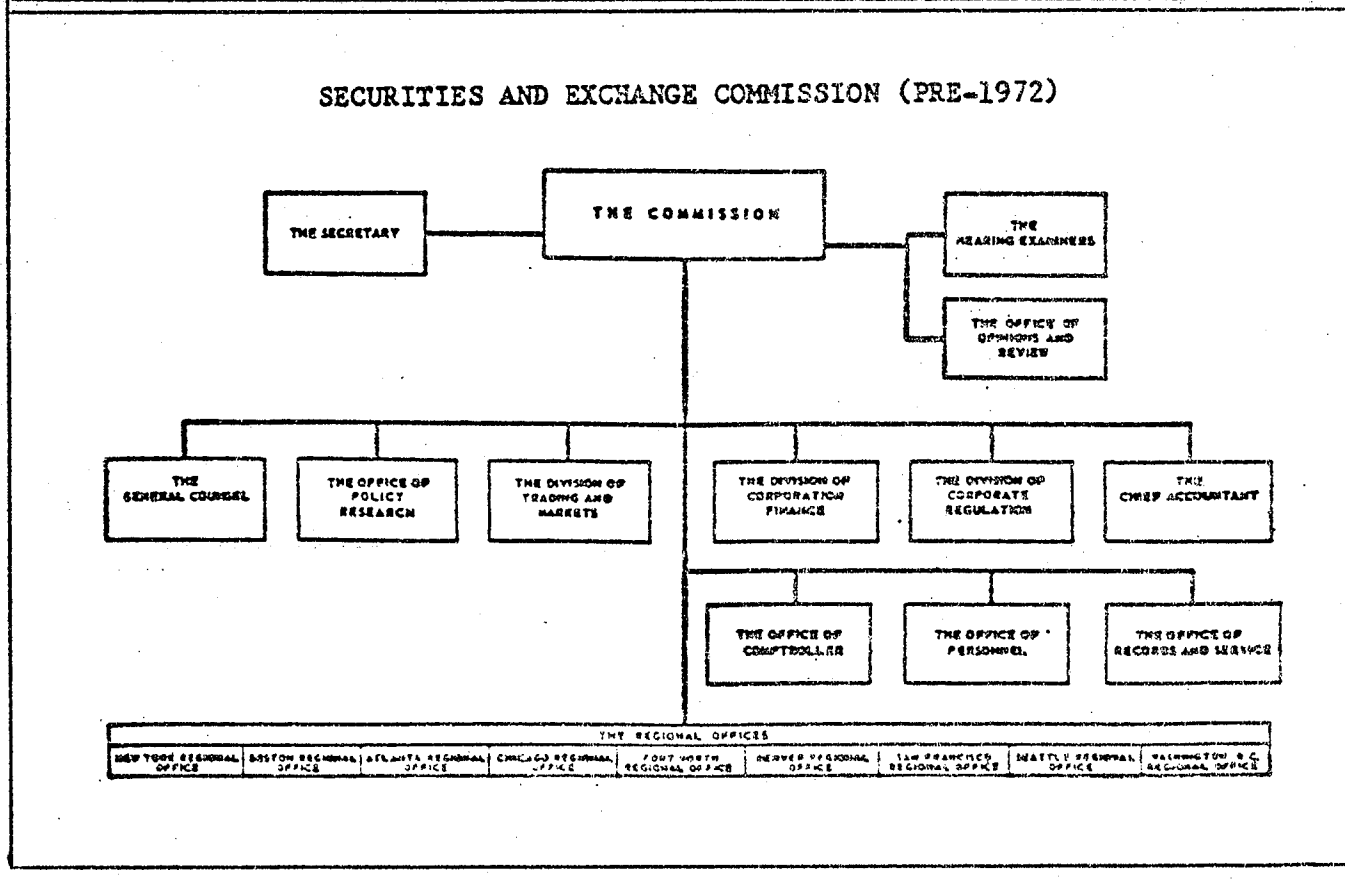
[11]The Division of Market Regulation is concerned with securities processing, market structure issues, self-regulatory oversight, compliance and financial responsibility of broker-dealers, municipal securities and legal policy. The Division of Investment Management Regulation is concerned with the regulation of investment companies and investment advisors.

FIGURE 3.2: SEC ORGANIZATIONAL STRUCTURE (POST-1972/PRE-1972)





Public Utilities Regulation administers the Public Utility Holding Company Act; the Branch of Investment Company Regulation administers the Investment Company Act; and the Office of Chief Counsel aids in Commission responsibilities under Chapter X of the Bankruptcy Act.

The Division of Trading and Markets is responsible for supervision of trading activities in the securities markets. These include registration of broker-dealers, supervision of the securities exchanges and the National Association of Securities Dealers (a self-regulatory broker-dealer association), surveillance of the trading markets, supervision and coordination of investigative and enforcement work being conducted primarily in the regions, and conducting general economic and statistical work.

In a brief review of Commission history, Richard Smith characterized its major priorities over four decades in an admittedly superficial summary. In the 40's, the concern was with financial restructuring of the utility industry, in the 50's with disclosure requirements and distribution rules for underwritings, in the 60's with the fiduciary obligations of the mutual funds, and in the 70's with the functioning of the securities markets (1971, p. 644). These priorities were reflected in the significance and staffing of the various operational divisions. Smith notes that in 1941, more than 250 staff members were working on public utilities (p. 635). Beginning in the mid 1940's, a burst of underwriting activity began, shifting the burden to disclosure work and enlarging the Division of Corporate Finance. By 1971, it was the largest division in manpower, with more than 370 staff members (of 1400 in the entire Commission)(p. 637). The late 1950's witnessed the growth of mutual funds, reflected in the Division of Corporate Regulation. By 1971, it had one hundred persons working on investment company regulation (p. 639). The increase of activities in the securities markets over time is reflected in the growth of the

Division of Trading and Markets from 75 in 1955 to more than 150 in 1963 (p. 640).

The final operating unit of the Commission is the regional office, which is responsible for investigating suspected securities violations, conducting routine and "cause" inspections of broker-dealers,[12] investment advisors, and investment companies, processing and evaluating broker-dealer annual reports of financial condition, filing and processing offering circulars by issuers to raise small amounts of capital (usually pursuant to Reg A), and dealing generally with the public.

Staffing and Appropriations

The Commission's staff consists of attorneys, investigators, accountants, security analysts, economists, engineers, and administrative and clerical personnel. More than 65% of agency positions are in professional categories, at least according to 1963 estimates (Annual Report 1963, p. 149). The first year of agency operation (fiscal 1935) the SEC had 692[13] employees and an appropriation of $1,545,327 ($6,397,695 in 1976 dollars[14]). In fiscal 1976, these figures were 1918 and $47,885,000.[15] The mean number of employees between

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[12]These are usually surprise inspections. It is not clear how frequently such inspections are conducted. Recently, they have been conducted annually by at least one regional office (interview, 8/16/76). In earlier years, they may have been less frequent, with inspections staggered every few years. Inspections are also conducted by the stock exchanges and the National Association of Securities Dealers of their members.

[13]All data presented in this section come from SEC Annual Reports.

[14]The source of these monetary conversions is based on "The Purchasing Power of the Consumer Dollar," "Consumer Price Index," U.S. Bureau of Labor Statistics.

[15]The Commission is also required by law to collect fees for registration of securities, registration of broker-dealers not affiliated with a registered securities association, registration of exchanges, qualification of trust indentures for certain filings, and certification of documents filed with the Commission. Fees can sometimes be as high as annual appropriations. In 1976, they represented 52% of Congressional appropriations.

1934 and 1976 was 1232, the median, 1176. Figure 3.3 presents SEC staff size and Congressional appropriations (based on 1976 dollars) between 1934 and 1976. As the graph indicates, throughout most of the agency's history, appropriations and staff size increase and decline at a corresponding rate - reflecting an appropriation of between ten and fifteen thousand (1976) dollars per employee. After 1961, appropriations radically take off, with a 1976 figure of $25,000/employee, probably reflecting, at least in part, higher federal salaries.[16]

The purpose of Figure 3.3, however, is to trace the growth of the SEC, and that is why 1976 monetary conversions rather than actual figures are presented. The image the graph projects is not one of significant growth throughout agency history, despite the stereotype of the burgeoning federal bureaucracy. Indeed, prior to 1974, staffing reached its peak in 1941 (1678), after which both staffing and appropriations dropped substantially until 1955 (662 employees). Since that time, staffing and appropriations have slowly increased (relative to the first seven years of the agency), just recently reattaining their former strength.

Another perspective on SEC growth is provided by contrasting it with the amount of business with which the agency is confronted. One might speculate that agency size should bear some relationship to the size and activity of the securities markets which the agency is charged to regulate. However, one could also speculate that regulatory problems increase with the demise of the markets and the relationship should be inverse. Figure 3.4 plots SEC staff size (solid line) against two indicators of this activity, the number of stock registrations (grey bars) and the number of broker-dealer registrations (white bars). These

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[16] Indeed, in 1962, a Federal Salary Reform Act was passed to alleviate the disparity between Government and industry starting salaries (Annual Report 1963, p. 149).

FIGURE 3.3: SEC STAFF SIZE AND APPROPRIATIONS

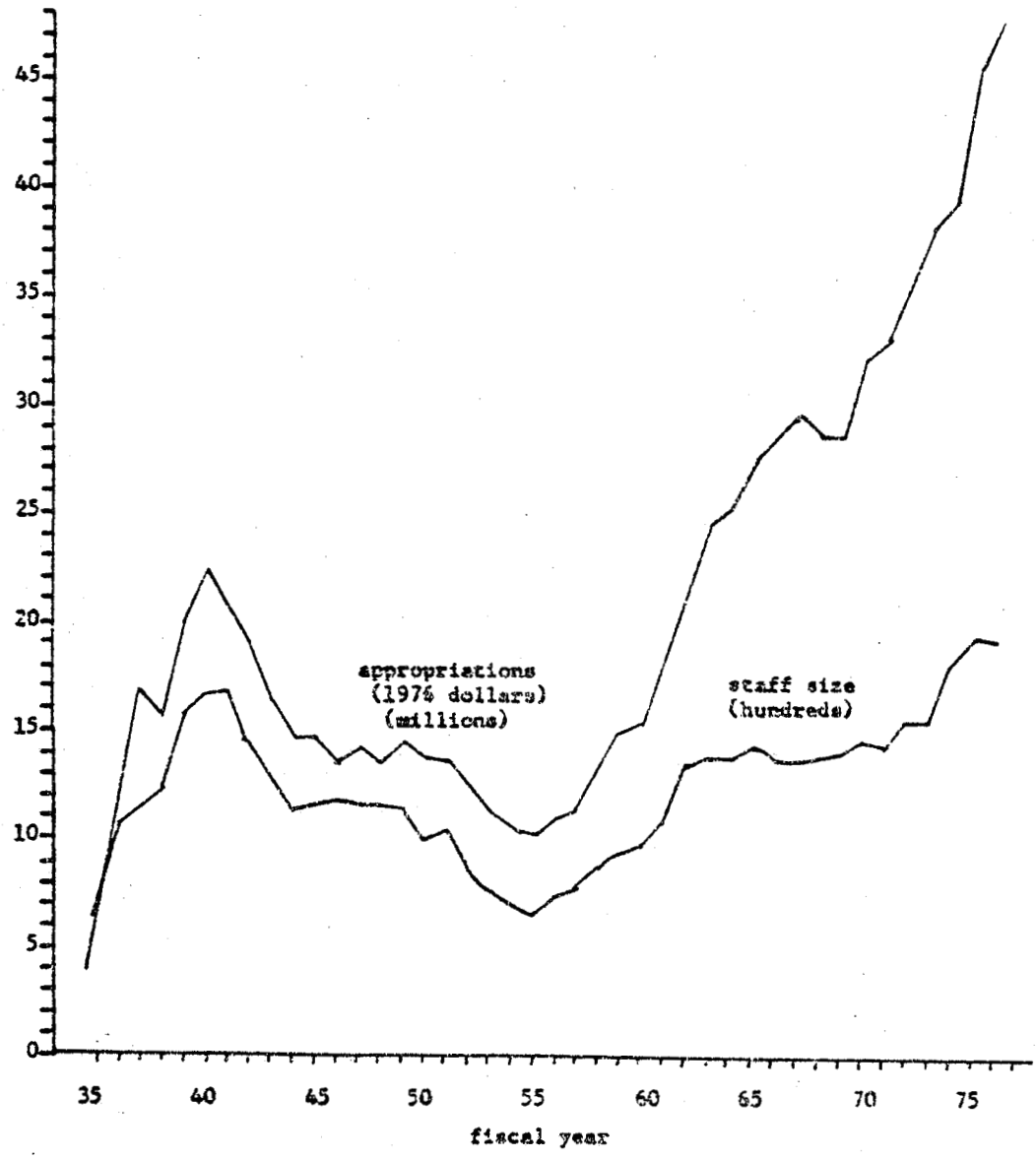
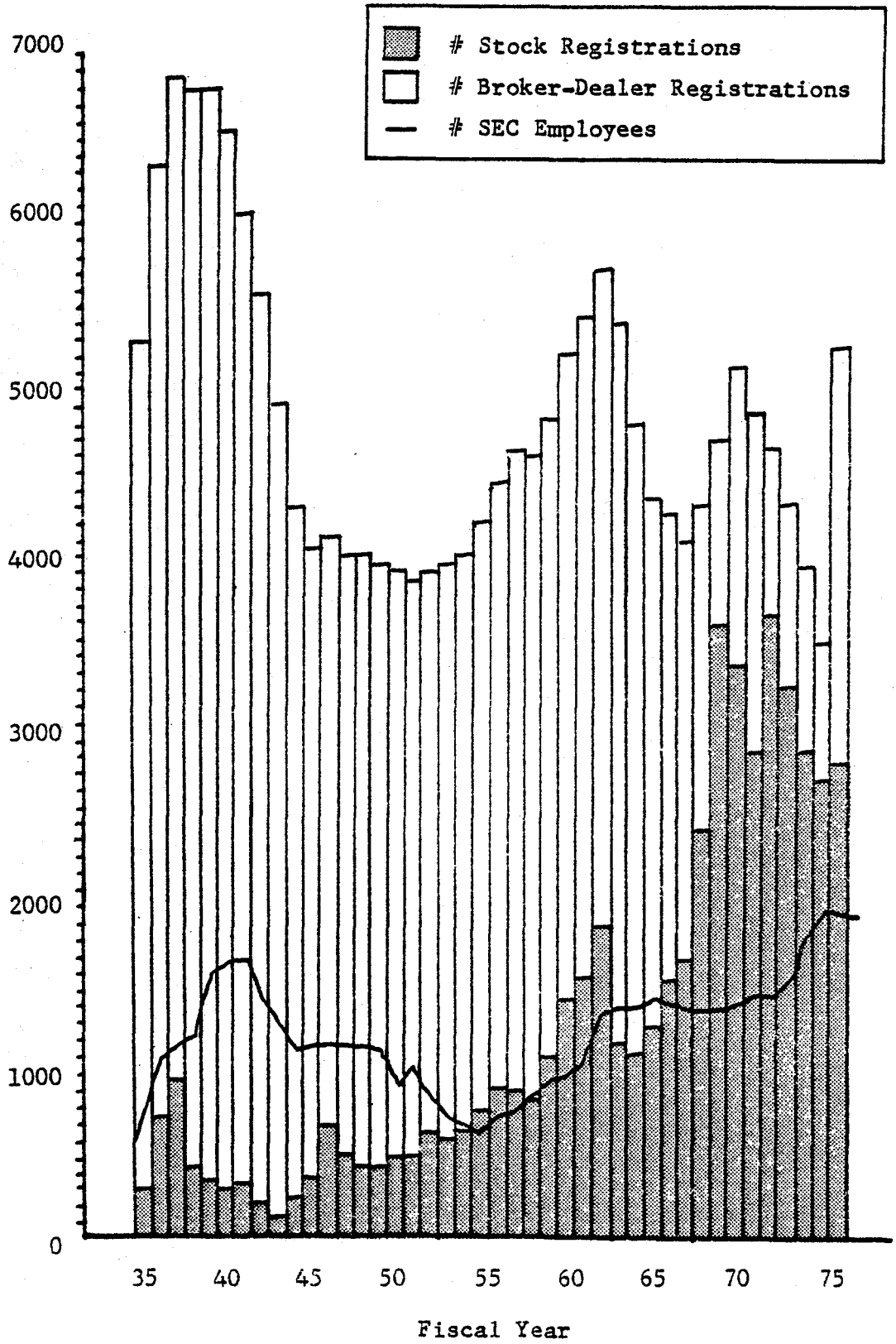


FIGURE 3.4: SEC STAFF SIZE RELATIVE TO STOCK AND BROKER-DEALER REGISTRATIONS



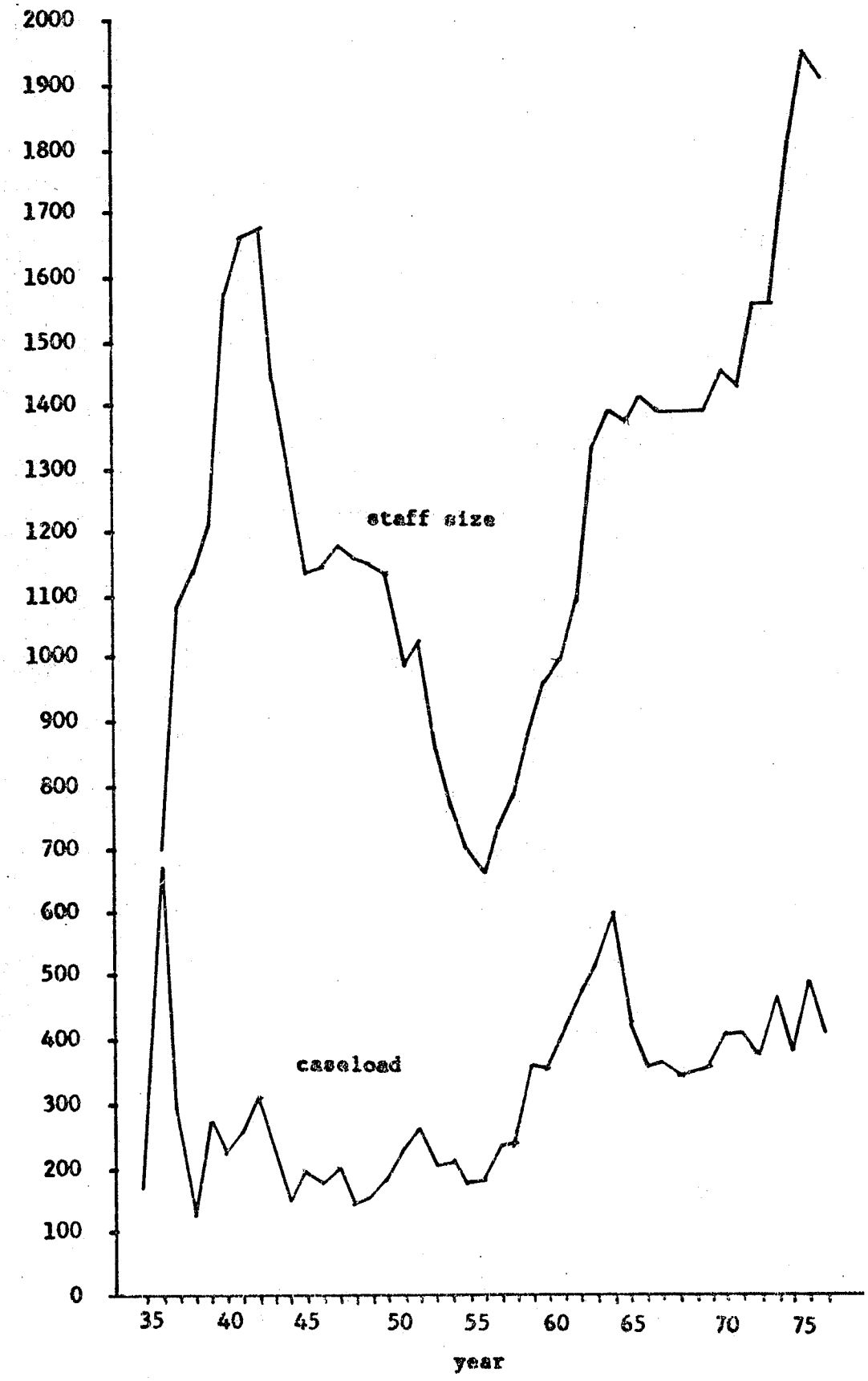
indicators are, of course, superficial, but do provide some perspective on staffing changes. As the figure indicates, staffing changes apparently correspond to rates of broker-dealer registrations prior to 1962 and more or less to numbers of stock registrations subsequently. The correspondence is by no means clear or predictable, but one gets the sense that agency growth more or less mirrors market growth.

Many of the factors underlying these patterns of agency growth were introduced in the review of SEC history. In the early years, the agency grew quickly, doubling its staff and tripling its budget within five years. Several factors contributed to the sharp decline in 1941: the completion of several major studies and much of the regulatory work associated with administration of the Public Utility Holding Company Act, but especially the onset of World War II (Robbins 1966, p. 66). As noted earlier, the securities markets and the Commission remained in the doldrums for at least a decade following the war. Increased staffing after 1955 reflects the rapid growth in the securities markets and stock offerings during this period, followed by the increased attention to securities regulation in the Kennedy administration. The plateauing of staff growth from the Kennedy assassination until the appointment of Ray Garrett in 1973 and the "rebirth" (Sobel 1977, p. 185) of the agency is rather clearly reflected in Figure 3.4. As noted earlier, most of the SEC growth during the mid-1970's was the result of the increasing role of SEC enforcement activities. Let us turn finally to a consideration of the organization and nature of enforcement work.

The Structure of Enforcement Work

Figure 3.5 presents the overall caseload of docketed investigations conducted by the Securities and Exchange Commission since its inception. Perhaps the most significant finding reflected in the figure has nothing to do

FIGURE 3.5: INVESTIGATIVE CASELOAD OVER TIME



with longitudinal trends. Rather it pertains to the rather small number of investigations instituted in any one year. On the average, the agency institutes and dockets 313 investigations annually, with a range between 145 (in 1947) and 674 (in 1935), the later figure of somewhat questionable reliability.[17]

As portrayed in the figure, the overall caseload has been gradually increasing over the years. With the exception of a slight drop in caseload during the years of World War II and a rather dramatic increase in the late 50's and early 60's, reflecting an explicit emphasis on enforcement in the wake of a strong and increasingly active securities market (see 1957-1960 Annual Reports), the pattern is fairly linear. The annual caseload in the mid 1970's is about double that of the first two decades of Commission enforcement. This increase is not surprising, given the growth of the federal regulatory agencies as well as of the securities industry. The upper line presented in Figure 3.5, which plots the number of all SEC staff by year[18] indicates that the growth in caseload has not kept pace with the growth of the Commission as a whole. The number of investigations instituted per employee has dropped from 5.1 before 1948 to 2.5 after 1972.[19] These differences should, of course, be taken with a grain of salt. The complexity of agency investigations has increased over time as well as the scope of the targets of enforcement. Most likely, caseload has not increased as sharply as staffing because the amount of investigative work

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[17] In contrast, the Internal Revenue Service opened over 9000 tax fraud investigations in fiscal 1976 (U.S. Internal Revenue Service, 1976 Annual Report).

[18] Data must be based on all SEC staff because the number of enforcement personnel are never broken out in annual reports.

[19] Figures for the intervening years:

1948-52	4.9
1953-57	3.5
1958-62	2.5
1963-67	3.3
1968-72	3.8

required per case has also increased.

The Home Office

The popular image of the Securities and Exchange Commission as being almost synonomous with its Division of Enforcement and of Washington, D.C. being the site of all the "action" in securities regulation, whatever its accuracy with regard to contemporary practice, truly fails to characterize the historical record. The creation of a separate Enforcement Division in the Headquarters (Home) Office was a byproduct of a fairly recent (1972) reorganization of the Commission. Prior to that time, enforcement work was located within each of the substantive divisions of the Home Office, though primarily in the Commission's regional offices. This characterization is affirmed by a variety of sources: documentary, interview, and actual caseload.

Agency annual reports as well as a document periodically issued, entitled The Work of the Securities and Exchange Commission, read like a broken record: "The regional offices form the front line of enforcement work" (The Work of the SEC 1941, p. 9) or "The primary responsibility for investigation rests with the Commission's regional administrators whose investigators conduct most of the field work." (Annual Report 1951, p. 154). Enforcement activity conducted by the regional offices was supervised and coordinated by a skeleton staff in the Headquarters, which, between about 1949 and 1972 (also the period of this research), was located within the Division of Trading and Markets. The Home Office enforcement machinery, then, was primarily a clearing house; it tracked regional office cases; it kept the Commission apprised of these activities and secured Commission authorization of enforcement action; it occasionally assigned personnel to assist in substantial regional office investigations; and its staff answered correspondence from the public. In contrast to the prestige associated with the contemporary enforcement role in the Home Office, attorneys in the

early 1950's took positions in this enforcement coordinative role hoping it would serve as a form of entre into a more prestigious position in the Division of Corporate Finance (interview, 12/16/77).

The annual reports suggest that where matters of public interest or urgency dictated, the Home Office might initiate in-house investigative activity. The rarity of this practice is shown in Table 3.1, which displays investigative caseload by regional office over time. Prior to 1958, the Home Office had docketed 91 investigations relative to figures in the regional offices ranging from 417 in Atlanta to 3035 in New York. Home Office investigations constituted only 1% of all docketed investigations during this period. This figure and that characterizing the over-all caseload of the Home Office is actually inflated. We recall from Chapter 2 that the Home Office was unusually high in the proportion of multiply docketed cases. Fifty-three percent of Home Office cases pertain to matters assigned other docket numbers as well. Typically, this practice occurred where multi-regional investigations were consolidated into a single case and assigned a Home Office docket number, despite the absence of direct involvement of Home Office staff in investigative work. Thus, probably only about half to two-thirds of all investigations allocated to the Home Office actually involve investigative work conducted by that office.

Although Table 3.1 clearly suggests the relative unimportance (quantitatively) of the Home Office in investigative conduct, it also suggests an important longitudinal trend. The office dramatically and consistently increased in relative caseload from 1% prior to 1953 to 15% after 1972. Annual reports and interview materials document this trend as well. Beginning in 1958, annual reports refer to a "Special Investigations Unit" in the Division of Trading and Exchanges, also called the "Office of Special Investigations" (1961), "Branch of Special Investigations, Trial and Enforcement" (1961), and

TABLE 3.1: REGIONAL OFFICE INVESTIGATIVE CASELOAD*

	Pre 1948**		1948-52		1953-57		1958-62		1963-67		1968-72		Post 1972**		Total 1934-76		Total 1948-72	
Atlanta	(299)	4%	(51)	5%	(67)	6%	(95)	4%	(87)	4%	(114)	6%	(85)	13%	(798)	5%	(414)	5%
Boston	(398)	5%	(37)	4%	(57)	5%	(109)	5%	(119)	6%	(119)	7%	(29)	5%	(868)	5%	(441)	5%
Chicago	(1365)	18%	(132)	13%	(88)	8%	(182)	9%	(191)	9%	(186)	11%	(67)	10%	(2211)	14%	(779)	10%
Denver	(677)	9%	(101)	10%	(156)	15%	(156)	7%	(217)	10%	(127)	7%	(35)	5%	(1469)	9%	(757)	9%
Ft. Worth	(811)	11%	(135)	13%	(108)	10%	(143)	7%	(153)	7%	(157)	9%	(47)	7%	(1554)	10%	(696	9%
New York	(2466)	33%	(316)	30%	(253)	24%	(817)	38%	(624)	30%	(393)	22%	(85)	13%	(4954)	30%	(2403)	30%
Seattle	(432)	6%	(113)	11%	(142)	14%	(231)	11%	(245)	12%	(200)	11%	(45)	7%	(1408)	9%	(931)	12%
San Francisco/ Los Angeles	(559)	7%	(67)	6%	(69)	7%	(163)	8%	(143)	7%	(130)	7%	(75)	12%	(1206)	7%	(572)	7%
Washington	(490)	6%	(80)	8%	(75)	7%	(123)	6%	(144)	7%	(159)	9%	(76)	12%	(1147)	7%	(581)	7%
Home Office	(55)	1%	(14)	1%	(22)	2%	(104)	5%	(181)	9%	(183)	10%	(96)	15%	(655)	4%	(504)	6%
Total	(7552)		(1046)		(1037)		(2123)		(2104)		(1768)		(640)		(16,270)		(8078)	

*Based on a listing of closed docketed investigations.

** Unreliable.

"Office of Enforcement" (1962) in subsequent years. This division was involved in some special problems of investigating boiler room operations in the New York area, and later an investigation of problems in the American Stock Exchange (AMEX) in the late 1950's and early 60's. During the course of these investigative efforts, it became clear that the SEC lacked the capacity for quick response to pressing matters, to matters of national scope, or to matters of depth, complexity, and breadth that were not being picked up by regional offices. The Home Office was the natural setting for developing such an investigative capacity, a development that got its impetus in its investigation of the AMEX scandals.

Shortly thereafter, the Home Office was involved in the execution of the "Special Study of the Securities Markets," a massive investigation of the adequacy of the national securities exchanges and associations for the protection of investors, ordered by Congress in September, 1961 and completed in mid 1963. The "Special Study" assembled a staff of about sixty-five persons, many of whom were subsequently available for enforcement work. By many accounts, the completion of the "Special Study" marked the emergence of the Home Office as a significant factor in the enforcement process (interviews, 8/16/76, 8/10/76, 12/16/77). In the ensuing years, a staff of specialists assembled in the Home Office to take on investigations of more complex patterns of violation (for example, involving complex accounting matters), those that involved multi-regional or international violations, the involvement of organized crime, novel interpretations of the securities laws or of the targets of enforcement, as well as traditional enforcement concerns. By 1976, the Division of Enforcement staff comprised about 15% of the staff of the Headquarters Office of the Commission. They numbered almost two hundred persons, about 61% of them attorneys and 14% accountants and securities analysts. During that year, about

seven hundred persons worked in the regional offices, a large proportion of whom were also engaged in enforcement work.

In a period of less than ten years, then, the Home Office developed from a small, reactive, caretaker office to a large, specialized, proactive, self-initiating office, constantly expanding the boundaries of enforcement policy and serving as a leader and model for the enforcement activities of the regions. Although this development is supported by the data assembled in this research, Home Office enforcement activity is grossly overshadowed by that of the regions, a fact that is easily overlooked by those who think that enforcement is synonomous with the activities located in the Headquarters Office.

The SEC Regional Offices

Despite the significance of the regions in the definition and shaping of SEC enforcement policy both quantitatively and qualitatively, extremely little is known about the SEC regional offices. Annual reports, for example, list the addresses and administrators of the regional offices. They do not even enumerate their staff or describe their budget, let alone allude to more subtle phenomena like enforcement policy or the structure of enforcement work. We have no idea how similar or different the regions are in investigative strategy or in the composition of the pool of enforcement matters with which they are occupied. Even the data reflected in Table 3.1, that break down investigative caseload by region were drawn from a non-public data file which required substantial effort to obtain from SEC personnel. The regional offices, then, are the SEC's great unknown quantity. I am not suggesting any insidious motives underlying this "cover-up." However, it helps sustain the myth that SEC enforcement work is truly national and centralized with uniform policies and practices.

Table 3.1 also presented regional office caseload over time. Although

there are some slight longitudinal trends in relative office caseload, the only significant trend is that already reported concerning the Home Office. The regional offices are remarkably stable in their relative share of investigative caseload over time. The table also demonstrates that, aside from the predominance of the New York regional office, comprising 30% of all investigations, the other regional offices are not terribly dissimilar in proportions of caseload. There are perhaps two tiers of offices: Seattle, Chicago, Denver and Ft. Worth, each conducting around a tenth of the investigations, and Washington, D.C.,[20] San Franscisco/Los Angeles, Atlanta, and Boston, somewhat smaller offices, whose caseload each comprise about 5-7% of the investigations.

This quantitative array of the regional offices most likely bears little correspondence to a qualitative array - providing some sense for the nature or organization of enforcement work, a sense that is absolutely unavailable from SEC documentary materials. We are told that the SEC regional office is like the cop on the beat - it takes in everything and anything that is encountered in the region (interviews, 4/30/76, 8/10/76, 3/21/77). In the social control jargon, while the Home Office can choose to be "proactive," the regional offices are necessarily "reactive." Thus, one might expect that regional office conduct is a reflection of the concerns of its constituency. And given the regional distribution of professionals in the securities industry and in the nature of capital seeking enterprises, one might expect that the nature of enforcement work would differ across the regions. There are more problems with the conduct of broker-dealers and of securities listed on the exchanges in New York, oil and gas cases in Ft. Worth, gold and silver mining cases in Seattle and Denver, problems with land and real estate in Atlanta (especially Florida) and

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[20]This is the Washington, D.C. <u>regional office</u>, not the Home Office.

California. And these differences, however superficial, say nothing about whether and in what way the nature of enforcement work is affected by characteristics of parties under investigation. We know nothing about differences in the organizational structure of the regional offices, of their relationships to self-regulatory agencies, state regulatory offices, the U.S. Attorneys' offices in their district, their relationship with and visibility to securities professionals, securities issuing organizations, and investors, and no data are available about changes in these phenomena over time.

The documentation of these questions would require another research endeavor, much of which would be near impossible because of the passage of time. The materials presented here, however spotty and superficial, should provide some sense for the social context in which investigative work is set. We move on to a consideration of the general contours of that investigative practice.

The Nature of Investigative Work

Section 20(a) of the 1933 Securities Act, Section 21(a) of the 1934 Securities Exchange Act, Section 18(a) of the 1935 Public Utility Holding Company Act, Section 321(a) of the 1939 Trust Indenture Act, Section 42(a) of the 1940 Investment Company Act, and Section 209(a) of the 1940 Investment Advisors Act all authorize the Commission to conduct investigations to determine whether the Federal securities laws have been violated. In most cases, investigations are non-public and the materials gathered confidential to ensure the cooperation of witnesses, but especially to protect persons about whom unfounded or unsubstantiated charges had been made.

In Chapter 2, the process by which allegations of illegality come to the attention of SEC staff and by which inquiries about these matters are docketed as formal investigations was described briefly. In Chapter 5, the sources of investigative inquiry are considered in much greater depth. This section of the

present chapter begins with the docketed investigation as given, and considers the nature of the investigative process. The organization of investigative activity, the nature of the evidence pursued, and the scope and magnitude of investigative activities are considered.

Investigative Resources

The investigative effort necessary to determine whether a violation has occurred, let alone that necessary to prepare a case for prosecution, is often considerable. Several resources are available to assist in this process: other social control organizations, other SEC regional offices, and the Formal Order of Investigation. When parties regulated by the Commission, particularly broker-dealers, are the subject of investigation, the agency has the power to inspect their offices and compel delivery of particular records. This power is not available for many other evidentiary sources, however. And one can imagine that subjects of investigation, as well as others who may be embarrassed or inconvenienced by cooperation with investigators, may be disinclined to do so. It is for this potential disinclination that the Formal Order of Investigation is a corrective. A passage in the 1952 SEC Annual Report (pp. 176-7) provides a useful description of the role of the formal order:

> Often it is determined, as a result of preliminary investigation, that witnesses may be unwilling to testify or produce necessary documentary evidence. Under such circumstances, since the investigation could not otherwise proceed, the facts are fully presented to the Commission with a request for a formal order empowering designated members of the staff to issue subpoenas requiring the appearance of witnesses, and the production of documentary evidence. The designated employees are authorized to administer oaths and to take sworn testimony. Such powers are granted by the Commission only after careful consideration and upon its determination that necessary evidence to complete the investigation cannot be obtained in any other way. The authority so delegated is strictly limited to the special subject matter of the particular investigation and cannot be used in any other matter.

This description applies to contemporary practice as well. The only major difference between the 1952 account and contemporary practice is its even greater contemporary popularity. In fiscal 1952, 41 formal orders were issued (16% of all investigations opened) in contrast to 224 (56%) in fiscal 1977. In 32% of all cases in the research sample, the Commission issued a Formal Order of Investigation to facilitate the investigative process. As expected, this proportion was lower (18%) when only broker-dealers were the subject of investigation than when stock issuers and their principals were subjects of investigation (41%).

Another investigatory resource is provided by the assistance or collaboration of other social control agencies. For 42% of the cases in the sample, other social control agencies or roles were consulted during the investigatory process. These included other federal regulatory or criminal justice agencies (7%), state securities commissions (9%), other state regulatory or criminal justice agencies (5%), self-regulatory agencies (i.e. stock exchanges, the National Association of Securities Dealers, Better Business Bureaus) (6%), foreign agencies (2%), corporate receivers (2%), and a mixture of these sources (9%). The nature of this inter-agency collaboration was diverse and not formally documented by the research. It ranged from the SEC simply inquiring of these agencies for information, records, or filings, to requests of self-regulatory agencies to make independent investigation, to agencies turning over an extensive investigatory record to SEC enforcement staff, to full investigatory collaboration between the SEC and other agencies. In most cases, inter-agency investigatory relationships were superficial, informal, and only marginally important to the full scope of investigatory effort.

Rather than turning to other agencies for investigatory assistance, SEC investigators may turn to other regional offices. This becomes necessary not

only because of limited investigatory resources, but because many securities violations are national in scope. The perpetrators of an offense may be located in Florida and their victims in the Pacific Northwest. Or the perpetrators may be moving around the country. Or the manipulated stock of a Texas corporation may have been traded on the New York Stock Exchange. Thus, it is sometimes necessary to obtain the assistance of other regions to pursue some aspect of the investigation. For 26% of the investigations overall, investigation was conducted multiregionally - 21% in two regional offices, 3% in three regional offices, and 1% in four or more regional offices. The likelihood of inter-office collaboration is quite variable across regional offices. As demonstrated in Table 3.2, the proportion of investigations conducted in a given region which are conducted only in that region ranges from 34% in the San Francisco to 80% in the Boston regional offices. It is not at all clear what to make of these figures. Those offices least likely to invoke other regions for

TABLE 3.2: THE EXTENT OF INTER-REGIONAL INVESTIGATION

Regional Office	% Investigations Only In This Region
San Francisco	34%
Home Office	36%
Denver	38%
Ft. Worth	38%
Atlanta	39%
Chicago	52%
Washington	54%
Seattle	61%
New York	65%
Boston	80%
(Total Cases)	(526)

investigatory assistance are among the largest and the smallest regional offices

in the agency. Perhaps more relevant than office size or resources in accounting for inter-office collaboration are regional differences in the kinds of illegality investigated and their geographic dispersion. New York and Boston are more concerned with the eastern brokerage establishments, the violations of which are usually contained within the brokerage offices themselves. Some of the other regional offices are more concerned with violations by stock issuers, the effects of which are often widely felt across the territories in which these stocks are marketed, hence necessitating the assistance of regional offices across these territories.

In any event, one can get a better feel for inter-office investigation by an examination of the constellations of collaborative relationships. The most popular office was the New York one; at least 10% of the investigations in all regions except Boston, Denver, and Seattle also involved work in the New York region. However, the region most likely to collaborate with New York was the Home Office, reflecting 10% of New York cases and 31% of Home Office cases. These relationships probably reflect the scope, centrality, and expertise of the New York office and its constituency over many securities transactions. The other major collaborative relationships primarily involved adjacent regions, most likely reflecting the geographical spread of patterns of illegality. Chicago collaborated with Ft. Worth (8% of Chicago cases); Ft. Worth with Chicago (10%) and Denver (15%); Denver with Ft. Worth (12%) and San Francisco (13%); San Francisco with Denver (14%) and Seattle (13%); Seattle with San Francisco (12%). For some reason, the Washington, D.C. and Atlanta offices also tended to collaborate with Denver (10% and 11% respectively).

Evidence

In the training of SEC enforcement personnel, staff members are introduced to a diverse and imaginative list of investigatory sources - from the

traditional corporate books and records; records of stock transactions; bank and tax records; testimony of informants, offenders, their associates and their victims; SEC records and filings; to records of other state and federal government and self-regulatory agencies (i.e. Justice Department, FBI, CIA, State Department, Social Security Administration, Post Office, Congressional Committees, state securities commissions, police, stock exchanges, NASD, etc.); to court records; real estate records; telephone records; credit card records; hotel and airline records; newspaper and periodical materials; Who's Who and other directories; exposes; records of marriage; wills; etc.[21]

In fact, a somewhat smaller set of evidentiary sources are typically found in investigatory files, at least during the period of this research. The most common of these are listed in Table 3.3, their incidence being not at all surprising. Most frequently (in 77% of all cases) the subjects of investigation themselves and their co-conspirators are questioned, their books, records, and minutes inspected (61% of all cases). Almost as frequently, (59%) their customers, investors, or victims are questioned either through direct interview or mailed questionnaires, where they can be specified and their testimony is salient to the alleged violation. And testimony from business associates of the subjects of investigation - corporate officers, directors, employees, brokers, attorneys, consultants - may be solicited (53% of all cases). Somewhat less frequently, SEC records and filings may be examined (48%) and the premises, books and records, of brokerage firms may be examined (36%). Although many of the other more esoteric forms of evidence may be pursued - bank, tax, phone, mail, credit card records, stock market trading data, the press, journalists, engineers inspecting mines or mechanical inventions - they are clearly

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[21]Based upon my participation in the SEC Enforcement Training Conference, Washington, D.C., July 26-30, 1976.

TABLE 3.3: EVIDENTARY SOURCES

	% Total Cases	Mean # Additional Sources
Examine Principals, Co-conspirators	77%	4
Examine Books, Records, Minutes	61%	4
Examine Tax Records	6%	6
Examine Bank Records	14%	6
Examine Other Records (i.e. phone, mail)	15%	6
Question Business Associates*	53%	5
Conduct Broker-Dealer Inspection	36%	5
Question Investors, Customers	59%	5
Examine SEC Records and Filings	48%	4
Examine Press, Media, Advertising, Journalists	11%	6
Examine Stock Market Data	5%	5
Use of Experts, Engineers	6%	6
Consult Other Social Control Agencies	42%	5
Rely on Previous Investigative Effort	12%	4
Total Cases	(526)	

*These include corporate officers, directors, employees, brokers, attorneys, accountants.

infrequent, as reflected in Table 3.3, with none of them employed in more than 15% of the cases. In 12% of the cases, usually involving multiple docketing, investigative efforts rely on previous investigative work.

This listing, though it enumerates the common sources of evidence pursued in an SEC investigation, reveals little about the richness and detail of actual investigatory activity - how one identifies which books and records are relevant; what one does and looks for when entering a brokerage firm and conducting an inspection; how one locates subjects of investigation, their conspirators, associates, or victims, and secures their testimony; the actual experience of entering a small community and talking to poor naive victims who feel betrayed, humiliated, and desperate; how one identifies a potential cover-up and attempts to penetrate it; how one bargains for testimony or attempts to "turn" insiders, convincing them to cooperate in the investigation; what one looks for when reading a prospectus or other sales literature; what tell-tale signs or red flags in patterns of securities trading are looked for; and finally, what it looks like when all of these activities, conducted by numerous staff members, over considerable periods of time, are assembled. Unfortunately this is a story that these data do not tell very well, and a story that really has never been told.[22]

Each of the evidentiary sources have been introduced separately to provide a feel for the entire spectrum of possibilities. However, a particular investigation represents a combination of these possibilities. The remainder of the discussion considers typical constellations of evidence and the scope or magnitude of investigatory effort. Table 3.3 enumerated the most common evidentiary sources for SEC investigations. As the high proportion of cases

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[22]Though, see some related journalistic accounts of securities swindles which introduce SEC investigations, if backhandedly, for example, Jones 1938, Patrick 1972, Dirks and Gross 1974, Maxa 1977, and McClintick 1977.

utilizing certain sources should have indicated, some investigations pursue more than one source. In fact, 10% of the cases pursue only one source, 11% two sources, 14% three sources, 16% four different sources, 15% five sources, and 17% seven or more sources. The median case utilized four different evidentiary sources.

The second column of Table 3.3 presents the median number of additional sources of evidence gathered for investigations that considered a given kind of evidence. For example, where the principals are examined, four additional sources of evidence are gathered on the average; in fact, 41% of these cases involve five or more additional sources. At the opposite extreme, 87% of those investigations which examine tax records obtain five or more additonal sources of evidence; its median is six. This distribution provides some sense for the adequacy of evidence derived from a particular source, reflected in the extent to which other evidence is necessary. Of course no one evidentiary source is complete in and of itself. But some, such as the examination of principals, corporate books and records, SEC records, and the reliance on previous investigations, seem more adequate than others, like the examination of records of other agencies (tax, bank, mail), the use of the press, or consultation with experts. Not surprisingly, the most direct sources of evidence are less likely to be supplemented by others than those least direct, which pertain to parties other than the offenders and agencies other than the SEC.

Another way to consider the intermixture of evidentiary sources is to explore the most common combinations of sources sought by investigators. Certain combinations of evidentiary sources are more frequent than one would expect on the basis of chance alone. The interviewing of business associates is frequently accompanied by consultation with other social control agencies, interviews of investors, broker-dealer inspections, and the scrutiny of

corporate books and records. Examination of corporate books and records are frequently accompanied by the examination of principals, business associates, and broker-dealer inspections. And, finally, investor interviews are more likely than expected by chance to be accompanied by consultation with other social control agencies. The most important correlations between the questioning of business associates and assorted other evidentiary sources and between the examination of corporate books and records and assorted other sources make some intuitive sense. Both business associates and books and records are rarely sufficient sources of evidence to substantiate illegality, yet they are often readily accessible in the course of pursuing other evidentiary leads.

The Scope of Investigatory Effort

A count of the total number of evidentiary sources explored is one indicator of the scope of an investigation. Another measures the amount of time devoted to investigative activity. It was impossible to devise a refined measure of this phenomenon, for example, some estimate of person hours, on the basis of records in the investigative file. A much grosser measure considers the actual passage of time from the institution of investigative activities to their completion (the latter date does not include any prosecution time). A longer duration of investigative activity may not indicate more substantial effort, rather it may reflect a low priority investigation with the matter spending substantial periods of time on investigators' back burners. Nonetheless, investigative duration is an important characteristic, whatever its cause. Docketed investigations in the research sample ranged in length from one day to more than eleven years. The mean length was 469 days (a little over 1 1/4 years), the median, 287 days (a little over 3/4 of a year). Fifty-seven percent of the investigations were completed within a year, 80% within two

years, 88% within three years, 93% within four years. Five percent of the investigations were still ongoing after five years.

The data include a final indicator of the scope of investigative activity. It is a proxy for a much more sensitive measure of the amount of time and resources expended in investigative activity, a measure which could not possibly have been computed from the available data. The measure, based on coder judgement[23] differentiates between the tremendous (2%), significant (9%), average (60%), and minor (27%) investigations and those based on no investigative activity at all, simply extensions of other cases (2%).

Despite the weaknesses of each of these measures - judgments of magnitude, the duration of investigatory activity, the number of evidentiary sources sought - they tell much the same story. The measures are highly intercorrelated. With regard to evidentiary sources, 6% of minor investigatons pursued six or more sources in contrast to 78% of the tremendous and significant investigations. With respect to investigative length, 7% of minor investigations lasted more than one and a half years in contrast to 62% of tremendous and significant investigations. Finally, 18% of the investigations taking less than three months in contrast to 56% of those taking more than one and a half years also involved six or more sources of evidence; 46% of investigations with less than three sources of evidence in contrast to 12% of those with six or more sources lasted less than three months.

Differences in these indicators of investigative scope were explored over time and by regional office. The results are by no means exciting. Longer duration cases and larger magnitude cases were slightly less likely to have been

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[23] Judgment was based on factors such as the number of investor interviews pursued, the number of books and records subpoenaed, the amount of testimony taken, the conduct of broker-dealer inspections, the use of engineers and other experts, the involvement of other social control agencies, an estimate of the number of attorneys, accountants, and investigators utilized, etc.

conducted in recent years, though the difference is barely perceptible. There are some rather substantial differences across regions, but they are very unsystematic. Long duration investigations are most characteristic of San Francisco and least characteristic of New York. Multi-evidentiary investigations are most characteristic of Atlanta and least characteristic of Boston and Washington, D.C. Yet the Home Office is one of the most likely to have many sources of evidence, and at the same time most likely to have few sources; and this pattern is reversed for New York. This might indicate greater heterogeneity of investigative content in these two regions.

An attempt to characterize the rich and fascinating phenomenon of investigative practice with quantitative measures and gross indicators is inherently frustrating. Unfortunately the limitations of the data collected as well as the scope of the dissertation require a treatment of this kind. Despite their superficiality, these materials hopefully provide some sense for the nature and contours of SEC investigatory practice. In the following section, the outcome of this investigative work as reflected in case disposition is considered.

The Disposition of Investigative Matters

The Decision to Take Formal Action

At some point in the course of investigative activity, a determination of the likelihood that violative conduct has been uncovered and, if so, of the desirability of taking formal legal action must be made. Of the docketed investigations included in the research sample, 15% resulted in the finding that no violation has occurred. These investigations were closed without formal action. Another 40% of the investigations were closed without formal legal action despite the discovery of violative conduct.

It would be impractical and counter-productive if every instance in which

some violative conduct was uncovered as a result of investigative activities were subject to formal proceedings. It is for that reason that the various securities laws vest the Commission with discretion in the decision to proceed formally against securities violators. Among the alternatives to formal proceedings, the Commission may refer the matter to other agencies, it may secure informal remedies, or it may simply close the investigation without taking any action. Each of these alternatives will be considered shortly. The primary question, of course, concerns the conditions under which agency discretion results in the decision not to take any formal legal action against securities violators - the outcome of almost half of all cases in the research sample in which illegal conduct was uncovered (213 of 449).

Annual reports and various instructional materials for new staff discuss some of the criteria to be evaluated in the decision to take formal legal action in response to illegality. These include whether the activity is continuing or likely to recur, the age of the violations, the nature of the offense, and whether it is the kind of scheme that poses the greatest threat to investors, whether offenders are about to abscond with victim funds or rather whether they have made victims whole, the need for remedial action, the impact of illegality on the public, the number and type of investors, the amount of money lost, the willfulness, inadvertence, and culpability of offenders, other offender characteristics (whether they are still in the securities business, whether they are chronic violators, whether they are associated with organized crime), concern for legal precedent, whether the case would be a suitable vehicle for the clarification of existing rules, and the like.

A more concrete view of the issues salient to prosecutorial[24] discretion is provided by an examination of the dispositions of actual investigative cases.

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[24]The term "prosecution" is used in this context to describe the decision to take

Data were gathered for the research sample on the justifications for case disposition actually articulated in the investigatory record, typically stated in the documents with which the case is formally closed. These justifications for the decision to take no formal action against securities violators are summarized in Table 3.4. Data in the table pertain only to the 213 cases in the sample in which formal action was not taken against securities violators. Since the "nonprosecution" of cases typically involves more than one justification, the number of responses (508) in Table 3.4 exceeds the number of cases (213). For most cases, it was possible to abstract some justificatory posture.

In only 3% of all cases was no justification given or was it impossible to ascertain the particular rationale. Of course the justifications articulated in the record may be incomplete or inaccurate, but their examination is nonetheless instructive.

By far the most common rationale for non-prosecution is the fact that the illegality is being or should be disposed in another social control setting. In 45% of these cases (#4,5), another agency was "prosecuting" the case (whether federal, state, or self-regulatory), the illegality was subject to private civil suits, and the like. For another 14% of the cases (#6,7) the illegality was being resolved by restitution, other corrective behavior, or other forms of settlement. And for another 14% of the cases (#2,3) jurisdictional problems dictated that the matter be proceeded against elsewhere; at least two-thirds of these cases were subsequently referred by the SEC to other agencies.

Another common justification (44% of all cases) for the decision to take no formal action pertained to matters of equity and other temporal features of the offense and its investigation (#8,9,10) - staleness of the offense, expiration

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formal legal action of any kind (civil, administrative, or criminal) against securities violators. It is not used here in its more narrow and common legal usage pertaining to criminal dispositions exclusively.

TABLE 3.4: JUSTIFICATIONS FOR NONPROSECUTION

	JUSTIFICATIONS	Number of Responses	% of Responses	% of Cases
(1)	None	2	*	1%
(2)	Referral to Another Agency	20	4%	9%
(3)	Jurisdictional Problem	9	2%	4%
(4)	Another Jurisdiction is Prosecuting	18	4%	8%
(5)	Other Proceedings, Actions Sanctions Sufficient	78	15%	37%
(6)	Restitution Was Made	20	4%	9%
(7)	Other Corrective Behavior, Settlement	10	2%	5%
(8)	Staleness, Statute of Limitations	23	4%	11%
(9)	Insufficient Equity	14	3%	7%
(10)	Illegal Activity Has Ceased	57	11%	27%
(11)	Principal Is Dead, Defunct, Inactive	23	4%	11%
(12)	Other Principal Characteristics (age, naivete)	22	4%	10%
(13)	Victim Characteristics (sophistication)	12	2%	6%
(14)	No Self-Benefit to Principals	7	1%	3%
(15)	No Evidence of Fraud, Not Willfull	21	4%	10%
(16)	Too Difficult to Prove Fraud	13	3%	6%
(17)	Lack of Evidence	39	8%	18%
(18)	Insufficient Severity, Magnitude Limited	47	9%	22%
(19)	Technical, Novel Legal Issues Involved	13	3%	6%
(20)	No Jury Appeal, U.S. Attorney Disinterest	6	1%	3%
(21)	Workload, More Pressing Cases	17	3%	8%
(22)	Cost of Investigation, Prosecution	7	1%	3%
(23)	Commission Refused to Prosecute	3	1%	1%
(24)	Other	22	4%	10%
(25)	Don't Know	5	1%	2%
Total		508	508	213

of statutes of limitations, the cessation of the illegal activity, etc. Three justifications, each used in about a fifth to a quarter of the cases, pertained to the particular characteristics of the offenders (#11,12) - that they were dead, defunct, very old, naive - or of their victims (#13) - that they were sophisticated, somewhat culpable - reflecting 27% of the cases; to problems of evidence, its insufficiency, the exhaustion of investigatory procedures, the lack of good witnesses, the difficulty of proving fraud or willfullness, etc. (#16,17) (24%); and to the extent of severity, victimization, or magnitude of the offenses (#18) (22%).

Some of the less common justifications pertained to the fact that the offense was not willful (#15) (10%), that principals did not personally benefit from their conduct (#14) (3%), that the legal issues involved were technical, ambiguous, or novel (#19) (6%), expectations that the case had little jury appeal or little appeal to the U.S. Attorney responsible for criminal prosecution (#20) (3%), or that the decision to take formal action would constitute an inappropriate drain on agency investigative resources (#21, 22) (5%). In three cases, the SEC Commissioners refused to approve staff recommendations for formal proceedings, the rationale for which could not be ascertained.

Although these justifications make intuitive sense and correspond to other sources in which the rationale for prosecution has been articulated, the question remains whether justifications actually correspond to concrete characteristics of the offense or its social control experience. Are cases which are prosecuted or sanctioned elsewhere really less likely to be proceeded against formally by the SEC? How about stale cases, those of limited severity, those with particular constellations of offenders and victims, those with particular investigatory strategies? This chapter is a general descriptive one

and not the appropriate setting to systematically examine these questions. Many of these questions were explored elsewhere, however (Shapiro 1978a). The most important findings of that analysis are summarized below.

The decision not to take formal legal action is most likely where cases are small - reflected in the number of offenders involved,[25] the amount of money involved in the offense,[26] the number of victims,[27] and the complexity of the violative conduct.[28] The justification pertaining to equity was borne out as well. Legal action was not taken against about half of all offenses still on-going at the time of investigation, in contrast to slightly more than two-thirds of those violations which had already ceased. The analysis also revealed differences in prosecutorial likelihood based on substantive characteristics of the violative conduct. Hypotheses based on the notion that non-SEC proceedings and sanctions and that informal remedies and settlements diminish the likelihood of formal legal action were not borne out by the data, though this finding may simply derive from the incompleteness of data concerning these alternative remedies. Hypotheses concerning offender and victim characteristics as well as evidentiary and other matters of investigative strategy, resources, or policy were not tested, primarily because of insufficient data or small N's. On the basis of both justifications articulated

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[25]Less than a quarter of those cases with one offender were prosecuted, in contrast to more than three-quarters of those with seven or more offenders (Shapiro 1978a, p. 14).

[26]The rate of prosecution increases consistently from 25% where less than $5000 was involved to 64% where in excess of half a million dollars was involved (Shapiro 1978, p. 15).

[27]Thirty percent of those cases with ten or fewer victims were prosecuted, as were 53% with 11-100 victims, and 62% of those cases with more than one hundred victims (Shapiro 1978a, p. 15).

[28]The rate of prosecution increases consistently from 25% of cases with only one or two violative activities to 77% of those cases with more than ten activities (Shapiro 1978a, p. 13).

in the investigatory record and empirical patterns in the data, it appears, then, that the major reasons for the decision not to take formal legal action in response to violative activity pertain to matters of its limited magnitude and impact and of its timing.

For about half of those cases in which illegalities were uncovered by investigation, some formal legal action is taken, however. Where staff investigators determine that such action is appropriate, they prepare a detailed memorandum, stating the nature of the offense, the evidence, the recommended form of legal action and justifications therefor. The memorandum passes through the various hierarchies of supervision and oversight among regional and Headquarters enforcement personnel, and eventually is presented to the SEC Commissioners, who must make the final prosecutorial decision. As noted in the previous section, pertaining to prosecutorial justifications, in three cases (1%), the Commissioners refused staff prosecutorial recommendations and the cases were closed without formal action. This figure is misleading. First, I am sure it understates the number of cases in which this outcome occurs. Most likely, in some instances, justifications in the record simply record the explanations given by Commissioners when they refuse prosecution -- staleness, magnitude, other formal actions, etc. Secondly, although Commissioners may approve staff recommendations that some formal action be taken in the case, they may substantially alter the substance of the recommended action. They may decide to include different parties in the action than those recommended by staff (for example, drop the inside counsel, add the chief executive officer), to invoke different forms of legal action (for example, respond civilly instead of criminally), or to alter the mode of action (for example, make administrative proceedings public rather than private).

The deliberative conduct of regulatory agency Commissioners, particularly

with regard to enforcement matters, is historically shrouded in secrecy. It is therefore difficult to characterize this critical juncture in case disposition in which enforcement matters are placed before the SEC Commissioners. My comments are based on observations of this process during a fleeting moment of several weeks in the forty-five year history of the agency. These observations may be extremely atypical of other SEC Commissions, Commissions that cover the period of the archival research which my observations do not.

SEC Commissioners spend several hours every day considering staff enforcement recommendations, whether for Formal Orders of Investigation, to take legal action, or to decide on settlement arrangements. Staff recommendations are rarely rubber-stamped (at least by the Commission I observed). They result in complex, detailed, and often heated discussions pertaining to details of particular offenses and of enforcement policy among Commissioners and staff, based on hundreds of pages of recommendations and documentary materials generated each day. The degree of attention taken to the minutia of the individual case and the evidence it generates was truly impressive. Determinations pertaining to all aspects of a given case often continued over days, weeks, or months. The Commission I observed made its determination on a consensual model - Commission preferences seemed to emerge after considerable discussion. Other Commissions perhaps relied on votes and more formal decision-making strategies. Of course, I am unaware of the discussion and politicking that occurred outside of the Commission chambers, the impact on enforcement policy generally as well as on particular enforcement matters of which may be substantial.

In any event, Commissioners must approve all of the three formal legal options available in response to SEC enforcement matters: civil and administrative proceedings and referrals for criminal prosecution. Any

combination of these proceedings as well as ancillary and informal remedies may be invoked in response to the violations of a particular case.

Types of Legal Remedies

Civil actions are initiated by SEC staff in the federal district courts. Typically, they are injunctive proceedings, the successful outcome of which enjoins the parties from future violations of the securities laws. In some instances, other forms of ancillary relief may be secured, for example, the appointment of receivers, supplemental investigation or disclosure. Injunctions are invoked where violations are ongoing or have a high likelihood of recurrence. Through temporary restraining orders, preliminary and permanent injunctions, civil actions seek to halt illegal activities. Although contested proceedings may involve protracted litigation, injunctive actions are frequently resolved by consent, in which the offender neither admits nor denies any wrongdoing, but agrees that he, she, or it will not violate the securities laws in the future. Failure to abide by an injunctive decree can result in criminal contempt proceedings. There is no other sanction attached to the injunction, although it may serve as a bar from future activities in the securities industry or as the basis for revocation of registration with the Commission. There are no restrictions on the nature of parties subject to civil remedies. Since 1934, over 2950 injunctive actions have been instituted and more than 10,000 defendants have been enjoined.[29]

The administrative proceeding is a public or private hearing, ordered by the Commission, and presided over by an administrative law judge. It can be quite lengthy and complex, with the presentation of voluminous documents, witnesses, and other testimony, or can be settled by consent or default without

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[29]Estimates are derived from SEC annual reports.

formal hearings. Administrative law judges generally make a disposition which is recommended to the Commissioners, who render the final disposition of the case. Defendants can request oral argument before the Commission and can appeal its decision to the federal courts. Although the law concerning the utilization of the SEC administrative proceeding has changed somewhat over the years, they are generally appropriate for persons or organizations bearing some kind of relationship to the Commission, either as registrants or their employees or as professionals who practice before the Commission (i.e. attorneys or accountants). The ultimate sanction emanating from an administrative proceeding terminates this relationship - the registration of a broker-dealer or investment advisor is revoked or the professional is barred from practice before the Commission. Less radical sanctions and ancillary remedies associated with administrative proceedings include temporary suspensions of business, employment, association with a regulated firm, or trading, expulsion or suspension from self-regulatory organizations, censure, alterations in the management or supervisory structure of the organization, restrictions on business practices, the voluntary withdrawal of the party from the securities business, and so on.

Criminal prosecutions are instituted in the federal district courts by the United States Department of Justice. Tyically, SEC staff make a determination that criminal prosecution is appropriate, and the Commission formally refers the case to the Justice Department. However, referral can be informal, as when persons in the Justice Department request investigative files prior to the authorization of a formal referral. In any event, the decision to refer the files must be rendered by the five SEC Commissioners. Criminal referrals are assigned to U.S. Attorneys who have the discretion to accept or decline the case for criminal prosecution. Although SEC staff frequently contribute to the

preparation of an indictment and to the eventual criminal trial, criminal prosecution and discretion over its outcome is vested in the U.S. Attorney. Criminal sanctions for the violation of the securities laws as well as of the mail fraud and conspiracy statutes, often included in these charges, during the period reflected in the research, include imprisonment of up to five years, fines of up to $10,000 (and up to $500,000 for securities exchanges), and probation. Conditions of probation sometimes include a bar from engaging in the securities business or an order to make restitution to victims. There is no restriction on the kind of parties liable for criminal prosecution. Since 1934, in excess of 1700 cases were referred to the Justice Department, resulting in the indictment of over 5200 and the conviction of over 3100 defendants.[30] In Appendix C, the various dispositional options, the available sanctions, and the supporting legislation for civil, administrative, and criminal proceedings are described in greater detail.

Table 3.5 displays the constellation of legal proceedings invoked for cases in the research sample. Numbers of proceedings are presented as a percentage of the number of cases in which formal legal action was taken (column b), of the number of cases in which violations were uncovered by investigation (column c), and of the total number of cases in the sample (column d). Eighty-three percent of the "prosecuted" cases were subjected to only one kind of proceeding; 15% to two kinds of proceeding; and 2% to civil, administrative, and criminal proceedings. Civil and administrative proceedings are equally likely (48% and 47%, respectively) to be invoked, and referrals for criminal prosecution are only half as likely (25%) to be invoked. Although civil and criminal proceedings are available for any securities violator, as noted above, administrative proceedings are available only where offenders are SEC

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[30] Estimates are derived from SEC annual reports.

TABLE 3.5: TYPES OF LEGAL PROCEEDINGS (Case)

	(a) (N)	(b) % of Total Proceedings*	(c) % of Total Violations**	(d) % of Total Cases
Civil Proceedings Only	(78)	33%	17%	15%
Administrative Proceedings Only	(80)	34%	18%	15%
Criminal Referral Only	(37)	16%	8%	7%
Civil and Administrative	(20)	8%	4%	4%
Civil and Criminal	(11)	5%	2%	2%
Administrative and Criminal	(5)	2%	1%	1%
Civil, Administrative, Criminal	(5)	2%	1%	1%
Total	(236)	(236)	(449)	(526)
All Civil	(114)	48%	25%	22%
All Administrative	(110)	47%	24%	21%
All Criminal	(58)	25%	13%	11%

* Excludes 290 cases that were closed without formal proceedings, regardless of whether investigation uncovered violations.

**Includes 213 cases in which violations were uncovered but were closed without formal proceedings. Excludes 77 cases in which no violations were uncovered.

registrants or bear some special relationship to the agency. If only those cases in which administrative remedies are available because of the composition of the offender population (N = 186) are considered, the proportion of administrative proceedings (54%) is higher than that reported for all cases in the sample. Thus, if "prosecutorial opportunity" or "availability" is taken into consideration, administrative proceedings are the most common response to violation, next to the non-prosecution of offenses, and criminal referrals, the least common response.

Table 3.6 displays the same data as that of the previous table, only this time the unit of analysis is the alleged offender (whether a person or organization) subject to investigation. Since most investigations pertain to the conduct of more than one party, the N (1934) is substantially higher than when the case is the unit of analysis (N = 526). A perusal of the table suggests that the distribution of instituted proceedings against individual parties mirrors that (within a few percentage points) pertaining to investigative cases. Even the ratio of the number of persons proceeded against to the total number investigated (46%) is the same as that pertaining to prosecuted cases as a function of investigated cases (45%). The only major difference between the two subgroups pertains to the frequency of multiple proceedings. Not surprisingly, the likelihood that a single party will be subjected to more than one kind of proceeding (11%) is lower than that for a particular case (17%). This follows from the possibility that multiple offenders investigated in a particular case may be subjected to single but different kinds of proceedings. This is especially the case for civil and criminal proceedings. Thirty-six percent and 32% of criminally and civilly prosecuted cases, respectively, are also subject to another kind of proceeding. This is the case for only 20% of the individual parties proceeded against

TABLE 3.6: TYPES OF LEGAL PROCEEDINGS (Offender)

	(a) (N)	(b) % of Total Offenders Proceeded Against*	(c) % of Total Violators**	(d) % of All Parties Investigated
Civil Proceedings Only	(346)	39%	20%	18%
Administrative Proceedings Only	(304)	34%	17%	16%
Criminal Referral Only	(149)	17%	8%	8%
Civil and Administrative	(58)	6%	3%	3%
Civil and Criminal	(15)	2%	1%	1%
Administrative and Criminal	(9)	1%	1%	*
Civil, Administrative, Criminal	(12)	1%	1%	1%
Total	(893)	(893)	(1754)	(1934)
All Civil	(431)	48%	25%	22%
All Administrative	(383)	43%	22%	20%
All Criminal	(185)	21%	11%	10%

* Excludes 1040 parties that were not proceeded against, regardless of whether investigation uncovered violations.

**Excludes 180 parties that were not proceeded against because investigation did not uncover violation. Includes 861 parties not proceeded against for whom violations were uncovered.

civilly or criminally.

Given the similarity of cases and individuals as analytic units, and since legal proceedings are instituted against offenders, not cases, the individual party will be the unit of analysis for the remainder of this section.

Civil Proceedings

As noted in Table 3.6, 431 parties (22% of the total sample of parties subject to investigation) were the subjects of civil injunctive proceedings. Slightly less than two-fifths of them were organizations; 45% were officers or directors of these organizations; slightly less than one-fifth were miscellaneous individuals. These parties represented 114 investigative cases, or an average of about three and three-quarters parties were named in each injunctive proceeding. Ninety-one percent of these parties were ultimately enjoined with a permanent injunction. Of the remainder, 2% were subject to a temporary restraining order and 3% were also subject to a preliminary injunction, but charges were ultimately either dismissed or were not supported after litigation. The presence of litigation was a relative rarity for these offenders: 80% settled charges by consent, 12% litigated; and 8% were enjoined by default. Only 36 parties (8%) appealed their injunction, and only a tenth of them succeeded with a reversal or an alteration of the ancillary remedies originally imposed. thus, the civil proceeding is a relatively "efficient" dispositional alternative for SEC investigators. Of 100 parties named in injunctive proceedings, at least 90 will ultimately be permanently enjoined, at a cost of having to litigate with only about 12 of them.[31]

As noted earlier, the outcome of injunctive proceedings can include more than simply enjoining offenders from future lawbreaking. Utilizing the broad

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[31]These ratios are about the same where the case rather than the individual is the unit of analysis.

powers of the Equity Court, it is possible to secure the grant of additional ancillary relief. Despite the considerable talk of the importance of ancillary relief in SEC injunctive proceedings both by the SEC (1976 Annual Report, p. 108) its staff, (Levine and Herlihy 1977, interview 3/21/77) as well as in scholarly articles (Treadway 1975, Farrand 1976, Mathews 1976), the use of such relief is relatively insignificant in the research sample. Most likely, this discrepancy reflects the greater use of ancillary remedies in recent years, a period underrepresented by this research.

Nonetheless, only 17% of the parties named in civil proceedings (23% of the cases) were additionally subjected to ancillary forms of relief. They are displayed in Table 3.7. As the distribution of data in that table indicates, the most common remedies are rather traditional, applicable to more severe and blatant forms of fraud - disgorgement, rescission, or restitution of illicitly acquired monies (7% of all proceedings and 30% of all remedies) and the appointment of a receiver, replacing incumbent management (5% of proceedings, 20% of all remedies). Some of the more novel and presumably current remedies, which shift the cost of investigation to the offender and attempt more subtle changes in corporate operations (supplemental reporting, special audits, restrictions on business practice, reorganization of management) are simply not very common. These latter categories reflect only 16 parties, 4% of all proceedings and 15% of all remedies. Among other infrequent remedies, each pertaining to less than 3% of all injunctive proceedings and 11% of all ancillary remedies, include amended filings, orders pertaining to proxy solicitations, freezing assets or records, suspensions or bars to professional or business activity, and the liquidation of offending organizations.

Administrative Proceedings

The major form of SEC administrative proceeding instituted in response to

TABLE 3.7: ANCILLARY REMEDIES IN INJUNCTIVE PROCEDURES

	(N)	% Total Remedies	% Total Proceedings*
None	(357)		83%
Amend Prior Filings	(12)	11%	3%
Supplemental Reporting Beyond that Normally Required	(8)	8%	2%
Special Audit	(5)	5%	1%
Orders Pertaining to Proxy Solicitations	(9)	9%	2%
Freeze Assets, Records	(5)	5%	1%
Disgorgement, Rescission, Restitution	(31)	30%	7%
Restrictions on Business Practices	(2)	2%	*
Other Suspensions or Bars	(2)	2%	*
Reorganize Management Structure	(1)	1%	*
Appoint Receiver Replacing Management	(21)	20%	5%
Liquidate Firm	(6)	6%	1%
Don't Know	(3)	3%	1%
Total Remedies	(105)	(105)	
Total Proceedings			(431)

*Percentages exceed 100% because 27 parties were subject to more than one remedy.

the findings of docketed investigations pertains to the activities of registered broker-dealers, investment advisors, their principals, and employees. Many of the kinds of administrative proceedings available to SEC enforcers and listed in Appendix C - suspension or revocation of the registration of securities exchanges or associations, stop orders, trading suspensions, and the like, rarely arise in this context. 2(e) proceedings against securities professionals (i.e. accountants and attorneys) pertaining to their privilege to appear or practice before the Commission only arose in three cases (examining the conduct of five individuals) in this sample. This discussion considers only those kinds of administrative proceedings that typically arise in the investigative context, pertaining to the denial, suspension, or revocation of broker-dealer or investment advisor registration with the Commission. Three hundred sixty parties were involved in revocations or suspensions, twenty-three in denials.[32] They represented 110 cases; about 3 1/2 parties were named per case. Of these parties, 37% were registered securities organizations (corporations, partnerships, sole-proprietorships), 45% were officers or directors of these organizations, and 18% were other employees or affiliated persons. Incidently, these proportions mirror exactly those subject to civil proceedings.

Of the administrative proceedings, about two-thirds were instituted publicly, a third privately. For about a third of the parties named in these proceedings, charges were "litigated" through hearings before administrative law judges; 61% settled charges by consent; and 7% by default. As is the case with civil proceedings, administrative proceedings are rather successful. Whatever the response of defendants to charges, 89% of them are ultimately found in violation, 1% are found innocent of charges, and proceedings against the

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[32]Revocations/suspensions pertain to parties already registered, denials to those applying for registration.

remaining 10% are dismissed or discontined. Only 3% of the parties appealed the disposition rendered by the administrative law judge. All dispositions were affirmed on appeal. Like civil proceedings, their administrative counterparts are quite successful, though as a result of more litigation. Of 100 parties named in administrative proceedings, 89 were found in violation, at a cost of having to litigate with 32 of them.

Table 3.8 displays the range of sanctions emanating from administrative proceedings.[33] About 5% of the parties found to be in violation or consenting to charges of violation were not sanctioned. Of the remaining 326 parties in this category, sanctions ranged in severity from censure (22% of them) to denials of registration applications (6%) to suspensions (from association with SEC registrants (8%), from stock exchange membership (2%), from membership in the National Association of Securities Dealers (NASD) (5%), of SEC registration (7%)) to permanent measures (revoking SEC registration (35%), barring association with an SEC registrant (13%), barring future SEC practice (1%), or expulsion from the NASD (11%)). The most common combination of sanctions, pertaining to 12% of all parties subject to sanctions and three-quarters of all parties subject to two or more sanctions, is the revocation of SEC registration coupled with expulsion from the NASD. As indicated in the table, suspensions generally ranged in length from one day to one year, with the median length of ten days for SEC registration suspensions and twenty-five days for other suspensions. Somewhat surprisingly, the invocation of severe sanctions, reflected in permanent measures, was more than twice as common as less severe sanctions, reflected in suspensions. Permanent sanctions were imposed on 64% of all parties sanctioned, suspensions on 23%.

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[33]For an analysis of SEC administrative sanctioning practice between 1967 and 1969, see Thomforde (1975).

TABLE 3.8: ADMINISTRATIVE SANCTIONS

	(N)	% of Sanctions	% of Parties*
None	(18)	--	5%
Censure	(74)	20%	22%
Deny Registration	(20)	5%	6%
Suspend Registration**	(23)	6%	7%
Revoke Registration	(120)	32%	35%
Suspend or Expel from Stock Exchange	(6)	2%	2%
Suspend from NASD***	(17)	5%	5%
Expel from NASD	(39)	10%	11%
Suspend from Association with a Registrant****	(29)	8%	8%
Bar from Association with a Registrant	(45)	12%	13%
Bar from SEC Practice	(4)	1%	1%
Total Sanctions		(377)	
Total Parties Named in Proceedings			(344)

*Fifty-one parties received more than one sanction, therefore percentages exceed 100%. The most common combination was registration revocation and expulsion from the NASD (N=39).

**Suspension ranged from 1 day to 1 year (median = 10 days).

***Suspension ranged from 1 day to 6 months (median = 25 days).

****Suspension ranged from 1 day to 1 year (median = 25 days).

As in civil proceedings, remedies ancillary to administrative sanctions are available in administrative proceedings. And like their civil counterparts, their occurrence is quite rare. Only 41 parties, 13% of those found in violation and subject to administrative sanctions, were also subject to ancillary remedies. And like the civil remedy data, the incidence of the more innovative remedies, attempting subtle changes in corporate conduct or disclosure, was quite low.

The distribution of these remedies imposed on parties in the sample is displayed in Table 3.9. The most common single remedy, representing 31% of all remedies, involves the agreement of parties to withdraw their registration with the SEC (sort of a voluntary revocation). The remaining remedies are of three kinds: (1) disclosure related (10% of all remedies) requiring amended filings, supplemental disclosure or special audits; (2) instituting new controls or restricting business practices (13% of all remedies); and (3) restrictions on employment possibilities of individuals (40% of all remedies) - either barring them from the securities industry permanently or subject to SEC approval, or limiting them to non-supervisory roles in the industry.

The presence of remedies ancillary to administrative sanctions is highly related to the form by which charges are litigated and its outcome. None of the cases disposed by default were subjected to ancillary remedies. This proportion was 5% for parties who litigated the charges and 17% for parties who consented to them. Furthermore, it appears that some kinds of ancillary remedies may substitute for administrative sanctions. Nine percent of the parties for whom sanctions were imposed were also subjected to ancillary remedies, in contrast to 61% of the unsanctioned parties. Another way of conceptualizing the issue: for parties subject to ancillary remedies, the likelihood of the imposition of sanctions is 73%, in contrast to 98% for parties not subject to these remedies.

TABLE 3.9: ANCILLARY REMEDIES IN ADMINISTRATIVE PROCEEDINGS

	(N)	% Total Remedies	% Total Proceedings*
None	(299)		88%
Withdraw Registration	(16)	31%	5%
Amend Filings, Supplemental Reporting	(4)	8%	1%
Special Audit	(1)	2%	0%
Institute Internal Corporate Procedures	(4)	8%	1%
Restrictions on Business Practices	(3)	6%	1%
Shift to a Non-Supervisory Capacity	(13)	25%	4%
Cannot Be a Broker, Dealer, or Principal Without SEC Approval	(6)	12%	2%
Stay Out of the Securities Business	(2)	4%	1%
Other	(3)	6%	1%
Total Remedies		(52)	
Total Proceedings			(340)

*Percentages exceed 100% because 11 parties were subject to more than one remedy.

This trend is especially pronounced for the remedies of withdrawing registration, restricting business practices, refraining from acting as a broker without SEC approval and agreeing to stay out of the securities business. The proportion of these parties for whom administrative sanctions were also imposed was 44%, 33%, 50%, and 0%, respectively, in contrast to 95% of all parties subject to administrative proceedings. Although it seems unlikely that administrative charges will be dropped without some form of response, it does appear that some charges may be dispensed without formal sanctions where parties consent to the imposition of ancillary remedies.

Referrals For Criminal Prosecution

The third formal legal response to the discovery of violative activity after investigation is the referral of the matter to the U.S. Department of Justice or a given U.S. Attorney for criminal prosecution. In doing so, a comprehensive criminal reference report, usually exceeding fifty pages in length, is prepared by SEC investigators, outlining the nature of the illegality and its victims, describing the conduct and background of offenders, co-conspirators, and other participants, reviewing the available evidence, witnesses, and the like, and usually recommending for which of the subset of participants criminal proceedings are appropriate. Among cases in the research sample, 58 cases, or 11% of the sample and 25% of all cases subject to some formal legal action were referred for criminal prosecution. In these criminal reference reports, 185 parties were named (165 individuals, 20 organizations) representing 10% of all parties investigated and 20% of those subjected to some legal proceeding. Criminal references involved a smaller number of offenders per case (less than three and a fifth) relative to civil (three and three quarters) or administrative (three and a half) proceedings. Subjects of criminal referral also differed in offender role from those subject to civil and

administrative proceedings, where 37% were organizations, 45% officers or directors of these organizations, and 18% miscellaneous persons. These figures for criminal referrals were 11%, 44%, and 45%, respectively. Criminal proceedings, then, emphasize the individual over the organizational offender, and, relative to other kinds of proceedings, the miscellaneous individual to the corporate officer or director.

Of the cases referred for criminal prosecution, at least 22% (and probably more) involved direct requests by Justice Department officials for investigative materials as opposed to unsolicited referrals. However, these officials are not compelled to prosecute all matters so referred. Prosecution was declined for 16% of the cases in the research sample and for 25% of all parties for whom criminal prosecution was recommended. The latter percentage is larger than the former because, in some instances, the referred case was ultimately criminally prosecuted, but the prosecution of particular proposed defendants was declined.

It is not always possible to determine the reasons for case declination by Justice Department officials. Even where the actual declination notification letter to SEC officials is attached to investigative records or where its contents are summarized by SEC officials and noted in the file, it is possible that stated justifications do not reflect actual justifications. And in some instances, declination is simply reported without explanation.

Some of the reasons offered for declination of SEC cases in the sample are noted below. Not surprisingly, many of the justifications by U.S. Attorneys for declining SEC criminal referrals, resemble those utilized by SEC investigators to justify the decision not to take formal action against securities violators, described earlier in the chapter. In some instances, other prosecutions or convictions of offenders on related matters were deemed sufficient. There were

jurisdictional arguments made concerning the appropriateness of federal jurisdiction. In two cases, U.S. Attorneys referred matters to the states and deferred declination until successful state prosecutions were completed. Justifications concerned evidentiary issues, the fact that witnesses were uncooperative, not credible, self-serving. A justification perhaps more typical of Justice Department declinations than of SEC non-prosecutions pertained to issues of marginality or ambiguity of the alleged illegal conduct. They argued that conduct reflected puffing, not misrepresentations, that statements were general, that accounting documents were questionable, but not improper. The intentional cover-up - the diffusion of responsibility, use of unwilling facilitators, the more subtle forms of misappropriation or self-dealing - became a justification for declination, based on the difficulty of proving fraud. Justifications also pertained to the fact that parties derived no self-benefit from their conduct and the difficulty of demonstrating intentionality. They pertained to the magnitude of the offense - that the "take" was small, the extent of injury minor - and problems of staleness and of the statute of limitations. Less frequently, declination was based on more general policy concerns.

Where cases were not declined but the prosecution of particular individuals was declined, justifications pertained frequently to the role of individuals in the illegal activity - that they were marginal, not the principal cause of the fraud, that the extent of their participation was small, that they were subordinates. These justifications were particularly likely where the main perpetrators were not subject to criminal prosecution because of death, plea-bargaining, and the like.[34]

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[34]Robert Rabin's study of Justice Department delination of referrals by all federal agencies during the early 1970's found that the most important justifications included considerations of "caseload, magnitude of the

As I observed in the discussion of SEC justifications for non-prosecution, it is unclear whether these justifications have any empirical reality - whether declined cases were really weaker, more minor, more ambiguous, the evidence more lacking than cases prosecuted. The sample is too small to determine jurisdictional patterns in declination - that some U.S. Attorneys declined cases that others would prosecute - although the suspicion that this is (or was) the case is supported by a variety of sources.

Despite these rationales, a substantial number of cases and defendants were ultimately prosecuted. Since prosecution is vested outside of the agency, the data available to document this process are more limited. For example, I was unable to learn anything about plea bargaining, grand jury presentations, and the like from SEC investigatory records. Nonetheless, data are available to document the outcome of the SEC criminal reference.

Table 3.10 sorts out the different outcomes befalling the subjects of criminal referrals. In additional to the subjects of declinations, another category of offender was spared criminal prosecution, represented by the 33 parties whose case was subject to a nolle prosequi. The circumstances surrounding nolles were diverse, including ill health, death of the defendant before trial (including suicide), fugitive status, other pending charges awaiting trial. Thus, only a little more than half of the original subjects of criminal referrals were ultimately subjected to criminal prosecution. Forty-six percent of them pleaded innocent; only twenty of them (19%) were acquitted. Rates of litigation, then, are much higher for criminal than for civil or administrative proceedings and, perhaps as a result, success (i.e. conviction)

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violation, court-perceived criminality of the offense, special characteristics of the defendant, existence of alternative sanctions, adequacy of the case, equality of treatment of regulated parties, and special interest influence" (1972, pp. iii - v).

rates are somewhat lower. Twenty defendants appealed their convictions, all of which were affirmed.

TABLE 3.10: THE OUTCOMES OF CRIMINAL REFERRAL

	(N)	% of Total Referrals	% of Total Prosecutions
Prosecution Declined	(48)	26%	----
Nolle Prosequi	(33)	18%	----
Acquitted	(20)	11%	19%
Convicted plead innocent (29) plead guilty (45) plead nolo contendere (11)	(85)	46%	81%
Total Parties Referred	(186)	(186)	
Total Parties Prosecuted	(105)		(105)

Available criminal penalties for securities violations include imprisonment (whether executed or suspended), probation, and fines. The sentences imposed for the research sample are displayed in Table 3.11. The most common sanction was a prison sentence, imposed on more than half of the defendants. Twenty-six percent received suspended prison sentences, 36% probation, and 18% fines. These latter three sanctions are usually not imposed alone. Suspended sentences are most often accompanied by fines; fines are accompanied by probation; probation by a fairly even number of each of the others. Prison sentences ranged from less than three months (4% of the defendants) to more than three years (27% of the defendants), with sentences as high as eight years. The

median prison sentence was two years. Suspended sentences ranged in length from nine months (14%) to more than three years (27%), with a sentence as high as 34 years. The median suspended sentence was two to three years. The modal length of probation (45%) was more than three years, with only 3% receiving less than one year probation; the median was two to three years. Fines ranged in magnitude from $1 to $36,000. A third of the defendants were fined less than

TABLE 3.11: CRIMINAL SENTENCES

	(N)	% Total Defendants*	% Only Sanction
Prison	(48)	56%	77%
Suspended Prison	(22)	26%	36%
Probation	(31)	36%	26%
Fine	(15)	18%	27%
Total Defendants		(85)	

*Twenty-eight defendants experienced more than 1 sanction. Therefore, percentages exceed 100%.

1,000, and a quarter more than $10,000. The median fine was $2,700 and the mean $6,446. In addition to these formal sentences, conditions were sometimes attached to sentences, including making restitution, staying out of the securities business, and never holding a position with a public corporation.

The Choice of Formal Legal Proceedings

An analysis of the conditions under which one or another or some combination of legal proceedings (civil, administrative, and/or criminal) is instituted is beyond the scope of this chapter and beyond the reader's sense of the data at this point. Elsewhere (Shapiro 1978a) this analysis was pursued more fully. Some of the more important themes deriving from that analysis are summarized below. An earlier portion of this chapter described offense-related characteristics associated with the decision to take any formal action - the magnitude of the offense, whether it was ongoing, and the substantive characteristics of the offense. Although these traits may characterize the pool of cases subjected to formal proceedings, these cases are not randomly sorted into civil, administrative, and criminal slots. Distinctive features of the offense dispose them for one kind of proceeding over another.

Civilly prosecuted cases are unresponsive to the substantive nature of the illegal conduct. Indeed, the distribution of offenses on substantive characteristics among civilly prosecuted and unprosecuted cases is almost identical (Shapiro 1978a, pp. 14-15). What distinguishes civilly prosecuted cases is that they are big cases - in the number of offenders, the complexity of the constellation of participants, in the aggregate number of illegalities under investigation, in the amount of money at issue in the offense, in the numbers of victims - and that they characterize recent, ongoing violations (p. 15-20).

Cases subject to criminal referral are radically different from their civil counterparts. The on-going character of the illegal activities is irrelevant to the institution of criminal referrals and, indeed, the recency of an offense bears a negative relationship to the likelihood of these proceedings. Criminal offenses are small in the structure of the offense - the number of offenders, the complexity of the constellation of participants. Rather, criminal cases

reflect offense severity both in terms of the substantive nature of the offense (especially fraud and misappropriation) and in terms of its impact or harm, reflected in extent of victimization and monetary damage. (pp. 20-23).

Cases subject to administrative proceedings are more of a mixed bag. By definition, they reflect offender characteristics, since only parties bearing some "relationship" to the SEC can be subjected to administrative proceedings. Like civil proceedings, administrative cases are big in structure - in numbers of offenders and numbers of violations - and reflect ongoing violative activities. Unlike both civil, and especially criminal cases, they are not necessarily big in impact or harm - in victimization and monetary damage. Rather, they respond to particular substantive kinds of offenses (violations of SEC technical requirements) as well as to the social context in which violation occurs, whether involving only SEC registrants or registrants and non-registrants (pp. 23-29).

If anything has been learned from this chapter, it is the complexity of the process by which investigative findings are translated into a prosecutorial strategy and ultimately a dispositional outcome. These superficial musings about the choice of formal legal proceedings seek to provide a flavor for some of the factors underlying this choice. They clearly do not characterize or explain this complex process. Two other elements of the dispositional process remain to be considered - the imposition of informal remedies unattached to legal proceedings and the experience of social control remedies external to the SEC.

Informal Remedies

In the previous section, the possibility and character of ancillary remedies attached to civil and administrative proceedings were described. However, some investigations resulted in the development of informal remedies,

settlements, or agreements, between offenders and the agency that do not receive the sanction of formal legal proceedings. These remedies reflect formal agreements between the SEC and offenders. They should be distinguished from voluntary actions taken by offenders without SEC action (i.e. payment of restitution). These are considered in the next section. In many instances, cases for which informal remedies have been secured are not subject to any formal proceedings. However, in many cases, informal remedies are joined by formal proceedings as well. Informal settlements may be secured, then, in an attempt to forestall any legal proceeding, to limit the scope of legal proceedings (i.e. to go civilly but not criminally) or to exempt particular offenders in a complex scheme from the reach of formal proceedings.

Twenty-two percent (101 cases) of all investigations that resulted in uncovering true violative conduct were also subject to informal remedies. Twenty-eight percent of those cases closed without formal legal action were disposed with informal remedies, in contrast to 17% of those which resulted in formal legal proceedings. The nature and distribution of informal remedies, broken down by prosecutorial outcome are displayed in Table 3.12. As the table indicates, the informal remedies are really a mixed bag, ranging from simple admissions of violation by the offender (2%) to agreements either to register with the agency or to withdraw or cancel registration (11% overall), to disclosure related agreements (amended or supplemental reporting, involved in 2% of the cases overall), to a wide range of remedial conduct by offenders - instituting new internal corporate procedures, restricting business practices, suspending or barring business, dismissing employees (4% overall), to actual dissolution of the firm (1% overall), to disgorgement of profits, rescission or restitution (4% overall). Two remedies are of a somewhat different character, since they reflect unilateral action taken by the SEC without the consent of the

TABLE 3.12: INFORMAL REMEDIES SECURED FROM SECURITIES VIOLATORS

	Violation/ No Prosecution		Prosecution		Total	
None	153	72%	195	83%	348	78%
Withdraw Registration	14	7%	10	4%	24	5%
Cancel Registration	5	2%	8	3%	13	3%
Amend Filings	3	1%	1	*	4	1%
Supplemental Reporting	2	1%	1	*	3	1%
Internal Procedures	5	2%	1	*	6	1%
Restrict Business Operations	3	1%	0	0%	3	1%
Disgorgements	16	8%	3	1%	19	4%
Suspensions/Bars	3	1%	2	1%	5	1%
Resignation/Fire	4	2%	0	0%	4	1%
Dissolve Firm	2	1%	1	*	3	1%
Admit Violation	9	4%	0	0%	9	2%
Suspend Trading	3	1%	10	4%	13	3%
Foreign Restricted List	2	1%	3	1%	5	1%
Registers	7	3%	5	2%	12	3%
Other	4	2%	2	1%	6	1%
Total Cases*	213		236		449	

*Remedies exceed total cases because 28 cases have more than one remedy.

offender. Trading suspensions, instituted in 3% of the cases, are actually administrative proceedings of a special kind, but they are listed here because they tend to be quite distinct from other dispositional processes and not always well documented in investigatory records. For one percent of the cases, securities were placed on the Foreign Restricted List, a document which puts brokers and investors on notice of unlawful distributions of foreign securities in the United States.

Because of small N's it is somewhat difficult to systematically contrast the constellation of ancillary remedies for prosecuted and unprosecuted cases. However, a few patterns do emerge. Voluntary admissions of violative conduct apparently spare offenders from prosecution. So too does the disgorgement, rescission or restitution of illicitly secured monies. Unprosecuted offenders seem a bit more likely than prosecuted ones to enter into agreements pertaining to corporate remedial conduct (7% vs. 1%). These inferences, of course, are merely conjectural. Clearly many violations are not prosecuted despite the absence of any informal agreements, indeed almost three-quarters of them; and many criteria in addition to informal settlements affect the decision to undertake formal prosecution. Nonetheless, the potential of such action may be employed as a strategic lever to compel corrective action by a few offenders along the margins.

Dispositions and Sanctions Emanating From Other Social Control Activities

One cannot close a discussion of the dispositions of SEC investigative cases without some consideration of the response to illegality occurring outside the agency, specifically, legal action taken by other social control organizations or jurisdictions, private civil suits, and other private sanctions. Since these phenomena occur outside of the purview of the SEC, the likelihood that they will be included in SEC investigative records is not high.

Therefore, the data upon which this consideration is based are among the least reliable in the dataset. They clearly underreport the incidence of other social control responses, and there may be reporting biases as well. Nonetheless, the data available are worthy of brief consideration. Data on other legal proceedings, private civil suits, and other private remedies or sanctions are displayed in Tables 3.13, 3.14, and 3.15, respectively. Each table indicates the overall distribution of these non-SEC responses to violation and breaks them down by SEC case disposition. The latter breakdown allows exploration of the question of whether external social control affects SEC prosecutorial discretion.

The data in Table 3.13 suggest that most SEC investigations (68%), including those which result in formal legal action by the SEC (58%), do not result in other legal proceedings. Note, however, that due to underreporting, these percentages are probably inflated. The most common setting in which additional legal control is imposed is that of the states, which take civil (9% of cases overall) or criminal (4%) action for violation of state statutes usually similar to the federal securities legislation. Two percent of the SEC cases were prosecuted by other federal agencies, perhaps for tax offenses, organized crime, and the like. Eight percent received sanctions from self-regulatory organizations (stock exchanges, the National Association of Securities Dealers) for violations of their regulations; 1% were proceeded against by foreign agencies; and 4% were responded to by a mixture of legal jurisdictions.

Data were also available on private civil suits by victims, investors and shareholders as well as civil litigation arising in the context of bankruptcy or receivership proceedings. As indicated in Table 3.14, 10% of the SEC cases (and 22% of those prosecuted by the SEC) were subjected to victim suits, 2% (and 4%

TABLE 3.13: OTHER NON-SEC LEGAL PROCEEDINGS

	No Violation (N)	%	No Prosecution (N)	%	Civil (N)	%	Administrative (N)	%	Criminal (N)	%	Total (N)	%
None	(70)	96%	(129)	65%	(68)	62%	(67)	63%	(23)	41%	(339)	68%
Federal	(0)	0%	(7)	4%	(1)	1%	(0)	0%	(2)	4%	(9)	2%
State Civil	(2)	3%	(25)	13%	(11)	10%	(10)	9%	(7)	12%	(47)	9%
State Criminal	(0)	0%	(12)	6%	(3)	3%	(0)	0%	(5)	9%	(20)	4%
Foreign	(0)	0%	(3)	2%	(2)	2%	(0)	0%	(1)	2%	(6)	1%
NASD	(0)	0%	(8)	4%	(13)	12%	(11)	10%	(4)	7%	(27)	5%
Stock Exchange	(0)	0%	(5)	3%	(3)	3%	(6)	6%	(3)	5%	(14)	3%
Mixed	(0)	0%	(7)	4%	(4)	4%	(5)	5%	(7)	12%	(21)	4%
Other	(1)	1%	(3)	2%	(4)	4%	(7)	7%	(4)	7%	(15)	3%
N	(73)		(199)		(109)		(106)		(56)		(498)	

TABLE 3.14: PRIVATE CIVIL SUITS

	No Violation		No Prosecution		Civil		Administrative		Criminal		Total	
	(N)	%	(N)	%	(N)	%	(N)	%	(N)	%	(N)	%
None	(72)	97%	(158)	80%	(86)	81%	(88)	87%	(32)	64%	(407)	83%
Victim Suit	(0)	0%	(22)	11%	(12)	11%	(11)	11%	(12)	24%	(49)	10%
Bankruptcy/ Receivership	(1)	1%	(3)	2%	(4)	4%	(1)	1%	(4)	8%	(11)	2%
Mixed/Other	(1)	1%	(15)	8%	(4)	4%	(1)	1%	(2)	4%	(21)	4%
N	(74)		(198)		(106)		(101)		(50)		(488)	

of SEC prosecuted cases) by bankruptcy related litigation, and 4% (3% of SEC prosecuted cases) experienced a mixture of the above or other civil litigation. Again, these proportions are probably depressed, due to underreporting.

Finally, data displayed in Table 3.15 are available on informal sanctions and remedies taken, typically by organizations, in response to violative conduct. Though there is some underreporting, such actions are a rarity, found in only 18% of all investigations and 22% of the investigations resulting in SEC prosecution. Offenders may make restitution (2% overall, 4% of prosecuted cases). Organizations may expell offending parties (5% overall, 5% of prosecuted cases) or go into receivership (5% overall, 9% of prosecuted cases).

One final perspective is afforded by these tables, an examination of the relationship between SEC and external dispositional processes. A hypothesis, derived from SEC justifications for non-prosecution, is that the relationship is an inverse one, the presence of external prosecution warrants SEC non-prosecution. However, the process is more complex. SEC actions may come first, and their success may encourage or facililtate other social control responses (i.e. private suits). Hence, the possibility of alternative extra-jurisdictional remedies may be unavailable at the time of SEC disposition. Furthermore, it may be that where illegalities are relatively trivial, any one sanctioning alternative is deemed sufficient; where they are severe, SEC action is deemed central regardless of other action. Thus, for trivial offenses, the relationship of SEC and other social control sanctions may be negative; for severe offenses, it may be positive.

It is impossible to tease all of these hypotheses and speculations out of the available data. A few patterns are clear, however. There is a small positive relationship between SEC prosecution and the imposition of other social control remedies. Where either other legal proceedings, private civil suits, or

TABLE 3.15: OTHER PRIVATE REMEDIES OR SANCTIONS

	No Violation (N)	%	No Prosecution (N)	%	Civil (N)	%	Administrative (N)	%	Criminal (N)	%	Total (N)	%
None	(71)	96%	(154)	78%	(86)	80%	(83)	81%	(36)	69%	(402)	82%
Expell Parties	(1)	1%	(12)	6%	(4)	4%	(3)	3%	(5)	10%	(23)	5%
Change Officers	(0)	0%	(2)	1%	(0)	0%	(0)	0%	(0)	0%	(2)	0%
Receivership	(0)	0%	(7)	4%	(9)	8%	(5)	5%	(9)	17%	(24)	5%
Restitution	(0)	0%	(4)	2%	(5)	5%	(5)	5%	(0)	0%	(12)	2%
Institute Controls	(1)	1%	(0)	0%	(0)	0%	(0)	0%	(0)	0%	(1)	0%
Mixed, Other	(1)	1%	(15)	8%	(3)	3%	(7)	7%	(0)	0%	(23)	5%
Unrelated Action	(0)	0%	(4)	2%	(1)	1%	(0)	0%	(2)	4%	(6)	1%
Total	(74)		(198)		(108)		(103)		(52)		(493)	

other social control measures are taken, the proportion of SEC prosecution is higher (by 6-10%) then where they are not. Furthermore, SEC prosecuted cases are more likely (by 7%) than unprosecuted cases to experience other legal proceedings, though there is no difference for the other kinds of social control. An examination of Tables 3.13 - 3.15 readily reveals the source of this small positive relationship: matters subject to SEC criminal prosecutions are much more likely than any other dispositional category to experience other social control dispositions. Fifty-nine percent of them are subjected to other legal proceedings; 36% to private suits; and 31% to other private remedies (in contrast to overall percentages of 32%, 17% and 18%, respectively). Whether the drama of a criminal prosecution instituted by the SEC justifies and facilitates other social control responses, or whether matters of this kind are so severe that they generate a multitude of unrelated responses is difficult to answer. What is clear, though, is that the likelihood that sanctions will be imposed in settings external to the SEC is greatest for offenses of the kind that often result in SEC criminal referrals.

Conclusion

This chapter has covered a great deal of territory and of history, beginning in the nineteenth century, fifty years prior to the creation of the Securities and Exchange Commission, and ending ninety-five years later with the present Commission. Among the numerous topics briefly considered include early regulatory efforts directed at public corporations and the capital markets, the state of the securities markets in the twentieth century, highlights of SEC history, the federal securities legislation, and the structure and organization of the SEC. The chapter also presented in greater depth a consideration of the enforcement work of the Commission and its organization, an attempt to set the record straight with regard to the locus of this work, a consideration of the

scope, nature, and implementation of investigative activities, and, finally, an examination of the available formal and informal SEC and non-SEC dispositional options to investigated allegations of illegality. In short, the chapter sought to place the enforcement work of the Commission within the context of the full scope of agency activities and of agency history. In the next chapter, the final introductory and contextual backdrop, pertaining to the offenders and offenses subject to enforcement, is put in place. Then the analytical work can begin.

CHAPTER 4: INTRODUCING THE SUBJECTS OF INVESTIGATIVE WORK: SECURITIES VIOLATORS, THEIR CONDUCT, AND THEIR VICTIMS

A final piece in the puzzle that provides an introductory sketch of the enforcement work of the Securities and Exchange Commission pertains to the targets of enforcement: the offenders and their activities. This chapter provides some background on the subjects of SEC investigation, the nature of the illegal activity in which they participate, and the victims it touches. Each of these elements will reappear in portions of the analysis later in the dissertation. Whereas that analysis will be microscopic in focus, zeroing in on specific details and constellations of illegal conduct, this discussion is telescopic, attempting to bring the whole picture into focus, regardless of detail, and to bring into view elements of this landscape that may not be placed under the microscope in later chapters. If the view it provides seems superficial, most likely more of its flesh will be revealed in later analysis.

The Subjects of SEC Investigation

In the 526 investigative cases included in the research sample, the conduct of over 1900 parties was examined, of which, 723 (37%) were organizations and 1211 (63%) individuals. Almost a fifth of the investigations pertained to a single party; one investigation examined at least fifty parties. The median was three parties per case; less than 5% of the investigations pertained to five or more subjects.

The enumeration of parties under investigation is a bit subjective and arbitrary. Parties were included as investigative targets in the data collection if, at some point in the investigative process, suspicions about their behavior developed which, if true, constituted SEC violations.[1] Thus,

[1]At a minimum, the list included all parties later included in formal SEC legal

parties were sometimes identified as targets of SEC investigation who were not involved in violative conduct, while their more culpable fellows were excluded because they were immune from SEC investigation. As emphasized in Chapter 2, this account is not the story of securities violations; rather it is the story of securities investigations. That which is investigated by the SEC is that which is enumerated in the research, however erroneous this may be from a perspective on "true" illegality.

Although more individuals than organizations were the subjects of SEC investigation and therefore each case has a larger number of individuals than organizations under investigation on the average (2.3 and 1.4, respectively), investigations were more likely to pertain to the conduct of at least one organization than at least one individual. For 17% of the cases, no individuals were under investigation and for 5% of them no organizations were targets of investigation. This is because there are very few securities offenses (perhaps some embezzlement and self-dealing) that are inherently personal offenses. More typically, illegality requires the involvement of both persons and organizations, characteristic of 78% of the cases in the sample. In the modal SEC case (72%), the conduct of only one organization and related individuals is under investigation. In almost a quarter of the cases, however, two or more organizations (and related persons), typically drawn from different industries, are the subjects of investigation. In this section, an attempt is made to tease out the identities and relationships of these multiple participants in securities violations and to provide some background data on their salient social characteristics.

Table 4.1 presents the distribution of the social roles played by both

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action. However, since only 893 parties were ultimately formally charged, the list of 1934 includes many unprosecuted participants suspected of violation.

TABLE 4.1: THE ROLE OR AFFILIATION OF PARTIES UNDER INVESTIGATION

	Organization		Person		Total	
Broker-Dealer	(283)	39%	(473)	39%	(756)	39%
Broker-Dealer Acting as Underwriter	(18)	2%	(12)	1%	(30)	2%
Investment Advisor	(18)	2%	(17)	1%	(35)	2%
Investment Company	(13)	2%	(32)	3%	(45)	2%
Stock Issuer	(354)	49%	(555)	46%	(909)	47%
Stock Promoter	(0)	0%	(23)	2%	(23)	1%
Shareholder	(1)	0%	(23)	2%	(24)	1%
Attorney	(2)	0%	(15)	1%	(17)	1%
Accountant	(3)	0%	(7)	1%	(10)	1%
Public Relations Firm	(1)	0%	(3)	0%	(4)	0%
Nominee	(0)	0%	(6)	0%	(6)	0%
Bank	(2)	0%	(4)	0%	(6)	0%
Insurance Company	(8)	1%	(4)	0%	(12)	1%
Miscellaneous Corporation (non-issuer)	(19)	3%	(12)	1%	(31)	2%
Miscellaneous Individual	(0)	0%	(17)	1%	(17)	1%
Other	(1)	0%	(6)	0%	(7)	0%
Dont't Know	(0)	0%	(2)	0%	(2)	0%
TOTAL	(723)		(1211)		(1934)	

individual and organizational parties subject to investigation. As the table makes quite clear, a disproportionate number of these parties, whether persons or organizations, are either broker-dealer firms or associated with them (41% overall) or stock issuers or their associates (47% overall).[2] Almost half of all cases (as opposed to subjects of investigation) involve investigations of at least one broker-dealer and 57% of the cases investigate at least one stock issuer. About a tenth of the cases pertain to the conduct of both brokers and issuers. Indeed, only 12% of the subjects of SEC investigation are unaffiliated with stock issuers or brokers, and many of the categories in which they are classified are clearly indirectly related (shareholders, promoters, accountants, attorneys, and public relations firms which work for them). Even investment companies and investment advisors, both important actors in the securities industry, and the subjects of their own legislative regulations[3] and enforcement agenda, account for only 3% of the parties under investigation. Although one may find the isolated case in which an unaffiliated individual attempts to manipulate the market of a stock or gets a tip and engages in insider trading, the opportunities for abuse and the jurisdictional issues that make an offense securities-related mean that most offenders will be drawn from the major actors in the securities industry: those who issue securities and those who broker them.

Although the vast majority of parties under investigation are similar in their affiliation with securities broker-dealers or issuers, they reflect a vast

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[2]The category of stock issuers includes much more than the prototypical public corporation listed on an exchange or traded over-the-counter. It includes any person or organization attempting to secure investments or to sell its securities within statutory definitions of these phenomena. The broker-dealer category pertains to firms within the securities business in the capacity of effecting securities transactions in the accounts of others or of buying or selling securities for their own account.

[3]The Investment Company Act of 1940 and the Investment Advisors Act of 1940.

array of other roles and characteristics. Those of both organizations and individuals are considered below.

Organizational Characteristics

As stated above, 723 or 37% of the parties under investigation, are organizations.[4] About four-fifths are corporations, 8% partnerships, and 13% sole proprietorships. Table 4.2 presents a very general classification of organizations on the basis of their Standard Industry Code, both overall, and for stock issuers only. This distinction is an important one, since more than half of the organizations overall are in the "finance" category because almost half of all organizations are securities firms. Excluding finance, by far the most popular industry from which offending organizations are represented is the mining industry, representing 35% of the issuers. This popularity derives from a large number of securities frauds involving oil and gas investments primarily in the Southwest and gold and silver mining investments primarily in the Northwest United States. The pool of stock issuers includes in smaller proportions manufacturing firms (electrical machinery, foods, chemicals, metals) (19%), finance, insurance, and real estate (13%), and services (recreation, health services, business services, membership organizations) (12%).

The organizations under investigation are predominantly small. Investigatory records provide little information on such corporate characteristics as total sales, profits, numbers of employees, etc. and, because of my agreement to maintain the privacy of all identities and identifying information of parties under investigation as a condition of access, it was

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[4]Over half of the organizations (a third of the issuers, four-fifths of the broker-dealers) were registered with the SEC in some capacity. Seven percent of the issuers were listed on a stock exchange. Eight percent of the broker-dealers were members of a stock exchange; 35% were members of the National Association of Securities Dealers.

TABLE 4.2: STANDARD INDUSTRY CODES FOR ORGANIZATIONS UNDER INVESTIGATION

	Stock Issuers Only		All Organizations	
Agriculture, Forestry, and Fishing	(14)	4%	(15)	2%
Mining*	(124)	35%	(127)	18%
Construction	(8)	2%	(11)	2%
Manufacturing	(66)	19%	(69)	10%
Transportation, communications, electric, gas, and sanitary services	(12)	3%	(12)	2%
Retail Trade	(9)	2%	(9)	1%
Finance, insurance, and real estate	(47)	13%	(393)	54%
Services	(43)	12%	(53)	7%
Shell or Dummy Corporations**	(18)	5%	(18)	2%
Don't Know	(13)	4%	(16)	2%
Total	(354)		(723)	

*Slightly more than half of the mining establishments involve metal mining, 37% involve oil and gas mining, and 9% the mining of minerals.

**"Shell" or "Dummy" corporations reflect defunct organizations which are revitalized so that their securities can be manipulated for fraudulent purposes. Their original industrial designation is truly irrelevant.

impossible to subsequently obtain corporate data from other sources. Measurement of corporate size is therefore extremely crude, based upon any characterizations found in investigatory records. It was possible to make even crude guesses for only 69% of the organizations. Bankrupt organizations (35%) were identified and discriminations were made between small (40%), medium (14%), large (8%), and extremely large (2%) organizations. Small organizations were more-or-less Mom and Pop operations, sole-proprietorships, businesses with fewer than 50 or so employees; extremely large organizations, Fortune 500 type corporations; and medium and large organizations filling the vast space between these boundaries. Broker-dealer firms were more likely to be bankrupt than issuers, in part because the SEC has certain technical regulations concerning maintenance of capital levels, bankruptcy, and organizational demise for broker-dealers. They were also more likely to reflect the smaller organizations, in part, because brokerage firms tend to be smaller than organizations issuing securities.

Organizations ranged in age from less than a year old to more than 100 years old. Data on age were available for 72% of the organizations. About a quarter of them were less than a year old, about half were less than three years old. About 10% were 10-20 years old and 8% more than 20 years old. There were no substantial differences in the age distribution of issuers and brokers. It is difficult to find comparable data on the longevity of all organizations of the kind that violate the securities laws with which to compare this distribution. It appears, however, that these offending organizations are rather "young." Presumably new corporations are breaking the securities laws with their earliest attempts to raise capital, new brokerage firms in their first attempts to market them. Whether explanations based on inadvertence and naivete are meaningful is really unclear.

Individual Characteristics

As noted earlier, 1211 individuals were investigated by the SEC in cases included in the research sample. Eighty-six percent of them were affiliated with securities issuers (46%) or brokers (40%). Almost all of these individuals (92%) were affiliated with an organization as co-participant in illegal activities. Most of these individuals were in the upper tiers of organizational hierarchies. A quarter were employees, 3% held managerial positions, while more than half held positions of control person (6%), sole proprietor (5%), general partner (9%), or officer (36%). Thirty-eight percent were also corporate directors; at least a third were beneficial owners. Investigated persons affiliated with broker-dealers were slightly more likely to be employees and slightly less likely to be officers, directors, or control persons than those affiliated with issuers, but the pattern is substantially the same. It is the conduct of the leaders of securities organizations that is most likely to be investigated.

Crude data were available on the securities and corporate experience of about three-quarters of these persons. Thirty-five percent of them (61% of those affililated with issuers[5] and 9% of those with brokers) had no securities experience. However, half of these parties (29% of those affiliated with issuers and 70% with brokers) had considerable securities experience, and the remaining 15% (10% and 21%, respectively) some securities experience. Parties for which data were available (only 15% of them) reflected a fairly wide age range: 6% were under 30, 30% between 30 and 39, 22% 40-49, 21% 50-59, 12% 60-69, and 9% over seventy. Twenty-five of them died at some point between the period of their alleged involvement in illegal activity and the close of the SEC

[5]In defense of these inexperienced issuer personnel, 83% did have experience in the industry in which they worked.

investigation. Parties affiliated with broker-dealers were somewhat younger than those affiliated with issuers. Forty-two percent of the former in contrast to 30% of the latter were under 40 years of age.

Recidivism

A critical issue in the study of deviance and social control and one largely unexplored in the study of white collar crime is that of recidivism. When SEC staff initiate an investigation, they check all of their files, previous investigatory records, and The Securities Violations Bulletin (which also monitors and updates enforcement in other jurisdictions) for previous offenses in which these parties, their aliases, or precurser organizations were involved.[6] Less systematically, investigators may seek evidence of other illegal activities beyond the range of securities offenses for which parties were previously investigated and/or prosecuted, utilizing, for example, FBI records. The likelihood of this secondary information being sought, though unlikely, is much greater where staff anticipate bringing criminal action.

The operational meaning of "recidivism," for purposes of this analysis, pertains to any previous investigation of a party for illegal conduct by any jurisdiction. Of the pool of "recidivist" offenders, it is possible to discriminate those who were also subjected to formal legal proceedings as a result of this prior investigation. However, given what we have learned about the rarity of formal prosecution despite violation, it seems desirable to begin with more liberal operational boundaries than those of traditional definitions of recidivism. For this research, data were gathered on the amount of recidivism, the nature of previous violations, and the nature of former dispositions, if any, for both persons and organizations. Rates of missing data on these variables were 35%, 42% and 45%, respectively. These data are,

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[6] In recent years, this process has been computerized.

therefore, both marginal and very uneven in quality.[7] However, they reflect one of the few examples of recidivism data on white collar offenders and of a consideration of recidivism that includes more than only previous criminal dispositions.

These data are displayed in Tables 4.3, 4.4, and 4.5. The tables probably provide more data and more discrimination than their reliability justify. At least 43% of all investigated parties in the sample for which data were available were subject to previous investigation, 4% of them on more than four occasions, and several of them more than 20 times. Since the bias in the data is in favor of underreporting, this proportion is probably actually much higher. As noted in Table 4.3: individuals are somewhat more likely to be subject to previous investigations (51%) than organizations (33%). Where the case rather than the individual party is the unit of analysis, the finding of recidivism is even more pronounced. At most, only about 36% of the cases investigated parties, none of whom had been subject to previous investigation.[8] Thus, probably two-thirds of all investigations and perhaps more, given incomplete data, concern parties at least one of whom is a recidivist.

In contrast to the extensive prior records of many street criminals, the data presented in Table 4.3 appear rather unimpressive; alleged securities violators simply don't have extensive records of investigation, let alone, prosecution. However, the proportion of parties with previous investigative

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[7]Chapter 2 contains a fuller discussion of the reliability of data of this kind.

[8]These case data are rather crude and are based on an aggregation of the party data. For 11% of the cases, it was impossible to ascertain recidivism. For 27% of the cases, none of the parties under investigation were recividists; for 9%, all parties for whom data were available were not recidivists, but data were unavailable for some of the participants. Eighteen percent of the cases had participants the majority of whom had low levels of recidivism (once or twice), 2% had moderate levels (three or four times), 2% had high levels (five or more times). For 32% of the cases, some or all participants were recidivists, but the extent of their recidivism was very mixed.

TABLE 4.3: THE NUMBER AND NATURE OF PREVIOUS OFFENSES INVESTIGATED

	Organization		Person		Total	
None	(365)	67%	(350)	49%	(715)	57%
One	(77)	14%	(79)	11%	(156)	12%
Two	(18)	3%	(38)	5%	(56)	4%
Three	(16)	3%	(34)	5%	(50)	4%
Four	(10)	2%	(15)	2%	(25)	2%
Five or More	(19)	3%	(36)	5%	(55)	4%
Don't Know - At Least One	(35)	6%	(123)	17%	(158)	12%
Don't Know - More than One	(4)	1%	(44)	6%	(48)	4%
Don't Know	(179)	--	(492)	--	(671)	--
TOTAL	(723)		(1211)		(1934)	
None	(365)	--	(350)	--	(715)	--
SEC Technical Violation Only	(17)	15%	(21)	7%	(38)	9%
SEC Registration Violation Only	(8)	7%	(17)	6%	(25)	6%
Federal Securities Fraud	(57)	51%	(177)	60%	(234)	57%
State Securities Violation	(5)	5%	(9)	3%	(14)	3%
Other White Collar Crime	(2)	2%	(21)	7%	(23)	6%
Street Crime	(0)	0%	(13)	4%	(13)	3%
Mixture	(22)	20%	(38)	13%	(60)	15%
Don't Know	(247)	--	(565)	--	(812)	--
TOTAL	(723)		(1211)		(1934)	
% Same as Present Offense	(26)	(23%)	(75)	25%	(101)	25%

experience is surprising for a white collar sample. SEC investigators might argue that this pattern is elevated by the inclusion of broker-dealers in the calculations who, by virtue of regular SEC inspections and closer regulation, are more likely to be investigated. This is only partly true. Half of the broker-dealers and their affiliated persons are "recividists", but so too are 39% of the other parties in the sample.

The bottom half of Table 4.3 lists the kinds of offenses for which parties were previously investigated. These offenses were predominantly (about 90%) securities violations of some kind, undoubtedly responsive in part to the way SEC staff gather recidivism data. Most of these prior offenses involve elements of federal securities fraud.[9] This was the case for half of all organizational recidivists and three-fifths of all person recidivists. Previous offenses involving only SEC technical or registration violations were much less common, reflecting only 15% of the recidivists. Organizations were more likely than persons to have been investigated for SEC technical violations. This reflects the fact that many technical regulations are inherently organizational.

As the table reflects, involvement of parties in previous investigations of state securities violations (at least 3%), other white collar offenses[10] (at least 6%), or street crime[11] (at least 3%) is relatively uncommon. Although organizations seem a bit more versatile than persons in their recidivism "repertoire" - 20% of the former and 13% of the latter were involved in a mixture of different offenses - individuals were more likely (at least 11%) than

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[9]This category may include previous offenses that involved SEC technical or registration violations as well as securities fraud.

[10]Examples of other white collar offenses included in this category are mail fraud and swindling.

[11]Examples of street crimes included in this category are organized crime, narcotics offenses, theft of government property, stolen securities, and murder.

organizations (at least 2%) to have been investigated for other white collar or street crimes.

As stated above when the broad operational boundaries of the "recidivism" label were justified, the fact that parties were previously investigated does not suggest that they did in fact actually participate in the offense nor that they were subject to legal proceedings for their participation. With Tables 4.4 and 4.5, the fact of and type of former proceedings to which these parties were subjected is considered.

TABLE 4.4: PREVIOUS FORMAL PROCEEDINGS IMPOSED ON "RECIDIVISTS"

	Organizations		Persons		Total	
None	(46)	43%	(63)	25%	(109)	31%
Criminal Proceedings	(12)	11%	(105)	42%	(117)	33%
Civil Proceedings	(28)	26%	(66)	27%	(94)	26%
Administrative Proceedings	(22)	20%	(43)	17%	(65)	18%
Self-Regulatory Proceedings	(15)	14%	(18)	7%	(33)	9%
TOTAL RECIDIVISTS*	(108)		(248)		(356)	

* A third of the recidivists were subjected to more than one proceeding, which explains why the sum of percentages exceeds 100.

Table 4.4 presents the previous proceedings imposed on these "recidivists." Sixty-nine percent of recidivists (57% of the organizations and 75% of the persons) were subjected to a formal legal proceeding of some kind. Indeed, more than a third of the recidivists were subject to more than one such proceeding. Unlike the distribution of prosecutorial options imposed in the current investigations, recidivists are more likely to have been subjected to criminal

proceedings (33%)[12] less likely to have been subjected to civil (26%) or administrative proceedings (18%) and least likely to have been subjected to self-regulatory proceedings. This finding may reflect biases in the reporting of previous dispositions rather than in rates of imposition of these dispositions.

Table 4.5 displays in much greater detail the actual outcomes of the previous proceedings to which recidivists were subjected. Like the data presented in Table 4.4, these distributions probably reflect reporting biases, and therefore are meant to indicate the range of dispositions imposed rather than any assertions about their likelihood. As each of the four cells indicate, the range of outcomes of each kind of proceeding is fairly similar to those which result from the proceedings reflected in the current research sample. As suggested in the tables, despite underreporting and reporting biases, a significant number of parties in the sample have experienced the most severe of the prosecutorial outcomes - imprisonment once or more (N = 46),[13] federal injunctions at least once (N = 54), and revocation of registration with the Commission (N = 22).

The previous discussion attempted to locate the subjects of SEC investigations in terms of their role in securities transactions, their affiliations, their securities experience, and their experience in prior illegal conduct. If the discussion seemed a bit heavy on the quantitative side, it is because it is difficult to appreciate who offenders are more fully until we understand what it is they have done. It is to the search for an answer (both quantitative and qualitative) to that question, that the remainder of this

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[12]Persons are almost four times more likely than organizations to be subject to previous criminal prosecutions. This derives from the rather limited criminal sanctions available for organizations.

[13]Including two given life sentences and one sentenced to death.

TABLE 4.5: OUTCOMES OF PREVIOUS LEGAL PROCEEDINGS AGAINST "RECIDIVISTS"*

	Organi-zation	Person	Total
I. Criminal Proceedings			
Acquittal	33%	10%	12%
Probation	0%	8%	7%
Fine	0%	5%	4%
Imprisonment Once	0%	35%	32%
Imprisonment More Than Once	0%	9%	8%
Other	25%	8%	9%
Don't Know Outcome	42%	27%	28%
TOTAL	(12)	(105)	(117)
II. Civil Proceedings			
Proceeding Dismissed	7%	3%	4%
Federal Injunction Once	43%	58%	53%
Federal Injunction More Than Once	4%	4%	4%
State Proceedings	43%	32%	35%
Don't Know Outcome	4%	3%	3%
TOTAL	(28)	(66)	(94)

*Most severe in each category coded.

continued

TABLE 4.5: OUTCOMES OF PREVIOUS LEGAL PROCEEDINGS AGAINST "RECIDIVISTS"*, continued

	Organi-zation	Person	Total
III. Administrative Proceedings			
Proceeding Dismissed	0%	2%	2%
Suspension	18%	26%	23%
Revocation	23%	40%	34%
Reg A, Trading Suspension	27%	9%	15%
Bar From Association	0%	2%	2%
Other	14%	14%	14%
Don't Know Outcome	18%	7%	11%
TOTAL	(22)	(43)	(65)
IV. Self-Regulatory Proceedings			
National Association of Securities Dealers	93%	83%	88%
Stock Exchange	7%	6%	6%
Other	0%	11%	6%
TOTAL	(15)	(18)	(33)

*Most severe in each category coded.

chapter is dedicated.

Types of Illegality Investigated

As noted earlier, the SEC has jurisdiction over the enforcement of seven different acts with sections and administrative regulations numbering into the hundreds. One way of conceptualizing the kinds of illegality subject to investigation is to label activities according to the act, sections, and/or regulations allegedly violated. Appendix C provides this information, listing statutory violations under investigation as indicated in enforcement records, and noting the number of cases for which a particular act/section/rule was salient.

The Appendix lists 69 such constellations of statutory violation, only six of which each reflect 10% of the cases or more. This fact begins to highlight the difficulties in using statutory designations to differentiate offenses. On the one hand, they discriminate too much (87% of the categories each had less than 4% of the cases in them). Identical illegal conduct by an issuer may be proscribed in the 1933 Securities Act, by a broker-dealer in 1934 Securities Exchange Act, by an investment advisor in the 1940 Investment Advisors Act, by an investment company in the 1940 Investment Company Act, and by an accountant or attorney in the SEC Rules of Practice. On the other hand, it doesn't discriminate enough. Almost a third of all investigations pertained to section 17 of the 1933 Act, which generally proscribes fraud, untrue statements, omissions, and touting. Additional criteria are needed to differentiate the huge assortment of securities frauds which investigators encounter and the contexts in which they occur. Finally, statutory discriminations are inadequate in that they provide no formula concerning the interrelationship of different statutory violations - of the similarity or dissimilarity in a more theoretical sense of the stock issuer and the stock broker who fail to register with the

Commission, of the broker who churns and abuses client accounts and the officer of a public corporation who engages in self-dealing, of the stock manipulator, and the insider trader.

Although statutory distinctions are important for certain purposes (particularly legal ones), they fail to provide a conceptualization sufficient for the analytic needs of this research, which require that the generic elements of illegal conduct be described and distinguished, without concern for the social role of the participants or the particularistic setting in which it occurs. The product of this conceptual effort is a 150 category scheme which codes up to 25 different elements of illegal activity for each case under investigation. The full code is listed in #20 (Illegality) in Appendix A.

A perusal of the coding scheme reveals its considerable detail. With regard to the 1933 Act, Section 17 anti-fraud example cited above, the coding scheme provides about a hundred different categories by which fraudulent activity can be distinguished - from several kinds of stock manipulation techniques to insider-trading to misrepresentations about the prospects of a corporation to misrepresentations about the return on investment to ponzi schemes, and the like. The coding scheme also recognizes the fact that securities violations rarely involve a single discrete act. A variety of misrepresentations may be necessary to successfully consummate a transaction; fraudulent activities may create technical violations; the cover-up of any kind of violation usually entails undertaking different violative activities; and so forth. Therefore, for each case, up to 25 different elements of illegal activity under investigation were recorded. The sample of 526 cases involved the investigation of over 2800 different elements of illegality, 5.4 per case on the average. The median number of elements per case was four; 18% of the cases involved a single type of illegal conduct, 13% involved ten or more.

Before we consider the complex questions regarding the intercorrelation of offense types or constellations of elements of illegality, it is necessary to address more basic questions concerning the meaning of the coding scheme and the empirical phenomena that its categories attempt to capture. The simplest distinction that sorts the hundred and fifty elements of illegal conduct coded, considers whether conduct entails violation of the registration requirements of the Commission, violation of technical rules and rules about business practices of agency registrants, or rather, fraudulent activities, embezzlement, etc. by any parties in the context of securities transactions. The results of sorting cases along these criteria are displayed in Table 4.6, for the overall sample and broken down for investigations of issuers only, of broker-dealers only, and of both issuers and broker-dealers. As the table reflects, the most common SEC investigation pertains to allegations of fraudulent conduct (76% of all cases), particularly when coupled with registration violations. Fifty-four percent of the cases pertain to registration violations (usually coupled with fraud), a quarter of them to technical violations.

Not surprisingly, this distribution varies considerably by the nature of participants in illegality. Broker-dealers, when acting alone are much more likely to be investigated for technical violations and much less likely to be investigated for registration violations or securities fraud than investigations pertaining to securities issuers alone or coupled with brokers. These differences are of the magnitude of 25-50%. If stock brokers are engaged in fraudulent activities or registration violations, they are more likely to be acting with stock issuers than acting alone or with other broker-dealers. Indeed, the offenses involving both issuers and brokers are remarkably similar in content to those involving only issuers, save the higher rate of technical violations (the broker-dealer contribution) and the slightly higher rate of

TABLE 4.6: GENERAL CLASSIFICATIONS OF ILLEGALITY

	Issuers		Both Issuers and Brokers		Brokers		Total**	
No Illegality*	(0)	0%	(0)	0%	(23)	12%	(24)	5%
Technical Violation Only	(3)	1%	(0)	0%	(46)	25%	(49)	9%
Registration Violations Only	(35)	15%	(6)	9%	(4)	2%	(50)	10%
Securities Fraud Only	(45)	20%	(13)	19%	(39)	21%	(112)	21%
Technical and Fraud	(6)	3%	(4)	6%	(36)	20%	(54)	10%
Registration and Fraud	(134)	59%	(40)	57%	(19)	10%	(205)	39%
Technical, Registration and Fraud	(5)	2%	(7)	10%	(17)	9%	(31)	6%
Don't Know	(0)	0%	(0)	0%	(1)	1%	(1)	0%
TOTAL CASES	(228)		(70)		(185)		(526)	
Any Technical Violations	(14)	6%	(11)	16%	(99)	54%	(134)	25%
Any Registration Violations	(174)	76%	(53)	76%	(40)	22%	(286)	54%
Any Securities Fraud	(190)	83%	(64)	91%	(111)	60%	(402)	76%

* Twenty-four investigations were instituted without allegations of violation, for example, to carefully scrutinize particular registration applicants.

**Total exceeds sum of columns because some investigations involve neither issuers nor brokers.

fraudulent activity.

These distinctions are so superficial, that it is difficult to disentangle these patterns and to get a sense for the actual conduct they encompass. A compromise position between these three categories and the 150 in the original coding scheme is the development of a set of twenty categories of illegality that summarize and differentiate the major distinctions in the original code and the major patterns in the empirical data. Table 4.7 presents a list of these categories along with the percent of all cases in the sample (and in the various offender sub-samples) in which allegations of these kinds were investigated. Appendix D maps the relationship of these categories to that of the original code. Items 1 and 2 correspond to registration violations in the tripartite distinction, 3-6 to technical violations, and 7-20 to securities fraud.

The major purpose of Table 4.7 is to serve as the transition to and organizing device for the more ethnographic discussion that follows. However, it provides two interesting insights in its own right. First, it helps disentangle some of the differences in patterns of illegality based on offender roles noted above. We learn, for example, that offenses involving issuers alone and issuers coupled with brokers are equally likely to involve misrepresentations about aspects of a corporation offering stock (items 13-16) but the latter are more likely to involve representations about aspects of the stock offering itself (items 17-19); or that stock manipulation offenses are most likely when issuers and brokers collaborate (34%) than when they act alone (10% and 3%, respectively); or that brokers acting alone are more likely to make misappropriations (33%) than issuers alone (27%) or both parties together (24%).

Secondly, the table provides a more realistic sense for the actual frequency of stereotypical elements of securities violations <u>subject to investigation</u>. For example, stock manipulation is reflected in only 10% of the

TABLE 4.7: MORE REFINED CLASSIFICATIONS OF ILLEGALITY

% Down	Issuers (N)	Issuers % of cases	Both Issuers and Brokers (N)	Both Issuers and Brokers % of cases	Brokers (N)	Brokers % of cases	Total* (N)	Total* % of cases
1. Registration Violations - Security	(167)	73%	(53)	76%	(36)	19%	(269)	51%
2. Registration Violations - Professional	(15)	7%	(8)	11%	(9)	5%	(40)	8%
3. Technical Violations - Issuers	(12)	5%	(6)	9%	(19)	10%	(41)	8%
4. Technical Violations - Broker-Dealers	(12)	5%	(9)	13%	(98)	53%	(126)	24%
5. Broker-Dealer Sales Techniques	(6)	3%	(10)	14%	(46)	25%	(66)	13%
6. Boiler Rooms	(4)	2%	(9)	13%	(14)	8%	(27)	5%
7. Previous Social Control	(13)	6%	(5)	7%	(43)	23%	(69)	13%
8. Stock Manipulation	(22)	10%	(24)	34%	(6)	3%	(55)	10%
9. Misappropriations	(61)	27%	(17)	24%	(61)	33%	(153)	29%
10. Self-Dealing	(34)	15%	(17)	24%	(10)	5%	(71)	13%
11. Investment Schemes	(21)	9%	(8)	11%	(7)	4%	(40)	8%

*Total exceeds sum of columns because some investigations involve neither issuers nor brokers

continued

TABLE 4.7: MORE REFINED CLASSIFICATIONS OF ILLEGALITY, continued

	Issuers		Both Issuers and Brokers		Brokers		Total*	
	(N)	% of cases	(N)	% of cases	(N)	% of cases	(N)	% of cases
12. General Misrepresentations	(11)	5%	(8)	11%	(6)	3%	(29)	6%
13. Misrepresentations About Status of Corporation	(133)	58%	(43)	61%	(52)	28%	(241)	46%
14. Misrepresentations About Future of Corporaton	(91)	40%	(28)	40%	(27)	15%	(154)	29%
15. Misrepresentations About Corporate Insiders	(49)	22%	(19)	27%	(30)	16%	(110)	21%
16. Misrepresentation About Corporate Oversight	(31)	14%	(11)	16%	(11)	6%	(54)	10%
17. Misrepresentations About Stock Offering	(113)	50%	(37)	53%	(39)	21%	(201)	38%
18. Misrepresentations About Broker-Dealer's Role	(6)	3%	(13)	19%	(18)	10%	(37)	7%
19. Misrepresentations About Return on Investment	(71)	31%	(30)	43%	(29)	16%	(139)	26%
20. Misrepresentations About Investment Advice	(4)	2%	(3)	4%	(2)	1%	(14)	3%
TOTAL CASES	(228)		(70)		(185)		(526)	

*Total exceeds sum of columns because some investigations involve neither issuers nor brokers.

cases; everything from insider trading to conflict of interest to bribes and kickbacks, all elements of self-dealing, in only 13% of the cases; investment schemes - ponzi and pyramid schemes, front money rackets, shell corporations - in only 8% of the cases. On the other hand, misappropriation of funds is an element of 29% of all cases investigated, violations of the SEC registration regulations in more than half.

The purpose of this chapter is not to provide a detailed analysis of patterns of illegality. Rather it is to provide some flavor for the nature of SEC work and the illegal activities it encounters. The following section adds some flesh to these twenty categories, describing their constituent elements and illustrating them with actual case material drawn from the sample. Chapter 2 contained a discussion of the differential consequences of drawing a research sample by random criteria as opposed to those based on legal precedent or significance. The reliance on the former criterion in the construction of this sample is also reflected in the illustrative materials. Few represent the very best examples of a particular offense, the kind one might find in a casebook. Some examples indeed seem rather trival. But these examples provide a better sense for the typical SEC case than reliance on their more dramatic counterparts could provide. Case narrations have been abridged considerably to simplify the discussion and to mask identifying information.

Registration Violations

Nonregistration of securities. Perhaps the fundamental prescription of all of the securities legislation is that which requires that before securities[14] may be offered or sold to the public, a registration statement must be filed with the SEC and must become effective. The Securities Act (1933) provides for

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[14]Securities are evidence of ownership or debt. They are defined in The Securities Act of 1933, which requires SEC registration, as: ". . . any note,

certain exemptions from registration, pertaining to private offerings to a limited number of persons or institutions (who have access to information and who do not redistribute these securities), offerings restricted to the state in which the issuing company does business, offerings not in excess of specified amounts and made in compliance with other regulations, securities of governments, charitable institutions, banks, certain interstate carriers, small business investment companies, and the like (The Work of the Securities and Exchange Commission 1974, p. 2). But a wide variety of transactions involving the offer and sale of securities are subject to SEC registration requirements. Nonetheless, some of them are not registered.

In a minority of cases, the transaction reflected an unusual or novel interpretation of the definition of a "security" and issuers were unaware that registration was required. There are a number of cases in the sample of the offering of so-called unregistered "investment contracts" - interest in citrus groves, catfish farms, Scotch whiskey, warehouse receipts, rare coins, and the like, where the offerers provide assorted services of farming, caretaking, storage, marketing, and distribution for the investors. In each of these cases, because the investor must rely on the services provided by the offerer for the success of the investment, it was deemed that these were investment contracts and required registration. In another case, promoters offered cruises to Central American countries where investor/participants would dive to recover treasures from sunken Spanish vessels, gold, and artifacts of the Mayan

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stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a 'security', temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing." (Section 2 (1)).

civilization. Since this scheme appeared to be a "profit-sharing agreement," and thus a security, it was investigated for possible violation of SEC registration requirements.

Some registration violations derived from the naivete or inadvertence of those offering securities, the newly emerging business enterprise whose promoter seeks investment capital unaware of the need to register, the business enterprise which alters its form of capitalization, and in the process, loses its exemption from securities registration, the accidental sale of securities in an intra-state exempted offering to someone from out-of-state. Other registration violations are far from inadvertent. Some reflect very creative and complex arrangements to cover-up the violations or to present them as if exempt from SEC registration. To qualify for the intra-state exemption, out-of-state investors may be required to drive into the state of issuance to purchase their securities and to list addresses of in-state motels, friends, or relatives as their residence. Stocks may be issued to a small number of "nominees" or "trustees" (qualifying either for intra-state or private placement exemptions) who subsequently distribute these shares widely to the public. In one case, control stock in a corporation was channeled through Swiss and German banks and Lichtenstein trusts to launder their source and evade registration requirements.

(a) Two officers of a New Mexico oil and gas corporation had the corporation issue 1,600,000 shares of stock to nominees and fictitious persons pursuant to fictitious sales, fictitious acquisition of assets, liquidation of non-existent corporate obligations and payments for fictitious services rendered to the corporation, and prepared false agreements, letters, and other documents to evidence the fictitious transactions. They then provided these spurious documents and false information to law firms to obtain favorable legal opinions indicating that these securities were exempt from the registration requirements or could be sold and transferred (which the officers subsequently did).

Although non-registration of securities through novelty, naivete, inadvertence, deception, or cover-up may be found in a minority of investigations, the presence of registration violations, whatever their cause, characterizes half of the investigations in the sample. Failure to register may occur during the original offering of corporate securities to the public or may occur during the attempted resale of personally owned shares of corporate insiders, parties who purchased them pursuant to exemptive provisions, and others. Often failure to register is an intentional act associated with a more complex securities fraud. Since registration or attempted registration brings securities issuers to the attention of the SEC and requires disclosure of information which, unless deceptive, would tip off SEC staff to their fraudulent designs, the registration process may prove injurious to the success of the scheme or may facilitate the social control process once the scheme is underway. Thus, only about a fifth of these cases involved registration violations exclusively; almost all of the remaining cases were also coupled with elements of securities fraud. And more than half (54%) of those offenses involving securities fraud also involved securities nonregistration.

Nonregistration of professionals and securities organizations. The Securities Act of 1934 and the Investment Company Act and Investment Advisors Act, both of 1940, require that certain securities professionals and securities organizations be registered with the Commission. These include national securities exchanges, national securities associations, brokers and dealers[15]

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[15]As defined in the 1934 Act, section 3 (4 and 5), "the term 'broker' means any person engaged in the businesss of effecting transactions in securities for the account of others, but does not include a bank;" "the term 'dealer' means any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business."

engaged in interstate over-the-counter securities business, investment companies, and investment advisors.[16] Like the provisions for the registration of securities, these acts provide various exemptions from registration. And as in the case of securities registration, some securities professionals nonetheless fail to register. However, the likelihood that violations of this kind will be investigated is much lower (8% of the cases) for professionals than for securities themselves (51%). Indeed, about two-thirds of the cases involving unregistered professionals also involve unregistered securities.

As in the nonregistration of securities, the nonregistration of professionals sometimes reflects naivete, inadvertence, or novel interpretations of the registration requirements.

(b) A group of nine friends and associates - engineers, draftsmen, and surveyors - formed an investment club. They each made a $50 deposit and a $20 monthly payment, the funds to be utilized to invest in real estate. The friends were unaware that their club must be registered as an investment company.

(c) An Ohio man widely advertised an investment opportunity in which investors would pay $25 with which he would buy U.S. Savings Bonds for $18.75. He would utilize the remaining $6.25 to invest in the stock market. Investors were promised a full return plus profits in nine years. The promoter had inadvertently created an investment company subject to SEC registration.

(d) An insurance company was selling variable annuity life insurance policies to residents of Arkansas. In these contracts, retirement income would be provided in units of common stock rather than in monetary units (supposedly as a hedge against inflation). The SEC argued that these were security sales and the insurance company, an unregistered investment company, a novel interpretation supported by a then recent U.S. Supreme Court decision.

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[16] Investment companies are those "engaged primarily in the business of investing, reinvesting and trading in securities and whose own securities are offered and sold to and held by the investing public . . . ."; investment advisors are " . . . persons or firms who engage for compensation in the business of advising others about their securities transactions . . . ." (The Work of the Securities and Exchange Commission 1974, pp. 16-18).

Sometimes securities professionals are well aware of the SEC registration provisions but are unable to register because of the terms of an injunction or conditions of parole or who are likely to be denied registration because of their record of previous offenses. In these instances, parties may simply neglect to register and continue to conduct business, may attempt to do business through nominees, or may create registered brokerage firms utilizing dummies as control persons while they actually control and conduct the business of the firm. Several investigations concerned the attempt of notorious con men or securities offenders to continue their brokerage activities through the assistance of "lady friends," neighbors, and a university professor fronting for them. That the nonregistration of professionals, like that of securities, is more likely intentional than inadvertent is reflected in the finding that 85% of these cases also involve allegations of securities fraud.

Technical Violations

Many of the SEC rules and regulations pertain specifically to the conduct of parties registered with the agency or those seeking exemptions from such registration. I have labeled failures to abide by these regulations "technical violations." Although many of the regulations - pertaining to disclosure or record-keeping, or maintenance of capital levels - have the effect of making fraudulent activity more difficult or minimizing the likelihood of victimization, their abrogration is not inherently fraudulent. This section pertains to technical violations by two categories of registrants: securities professionals and public corporations.

Technical violations of securities professionals. About a quarter of all cases in the sample and 42% of those investigating the conduct of broker-dealers included allegations of technical violations by securities professionals. The

most common of these were violations of the bookkeeping rules (48% of these cases) which require that certain books, records, ledgers, and the like, be kept and be current; delinquency or failure to file annual reports of financial condition with the SEC (44% of these cases); and violations of net capital rules (44% of these cases) that pertain to the level of capitalization required for registered broker-dealers. Much less frequent offenses pertain to regulations about the extension of credit to clients, segregating customer accounts, use of customer securities as collateral for loans, delivery of securities, and about the confirmation of customer transactions.

Because of the regional distribution of the securities profession, many of these technical violations were investigated by the New York regional office. Thirty-two percent of its cases involved technical violations in contrast to 20% of the other regional offices. The incidence of technical violations is differentially distributed temporally as well as geographically, reflecting technological developments, the state of the securities markets and the associated demand on brokers. During the late 1960's, many brokerage firms were plagued by "back office" or "paper work" problems created by a sudden and unprecedented rise in trading volume without a commensurate increase in brokerage facilities to handle the clearance, transfer, bookkeeping and delivery of securities traded.[17] The aftermath of the back office crunch was serious financial difficulty for many brokerage firms. All of these problems are reflected in rates of technical violations though not as much as one might expect. Twenty-one percent of the cases opened before 1969 pertained to technical violations compared to 37% after this period.

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[17]These problems are reflected in a rise in investor complaints to the SEC pertaining to broker-dealers from 3,991 in fiscal 1968 to 12,494 in fiscal 1969. (35th Annual Report 1969, p. 2).

Technical violations by public corporations. This offense category is far less common in the sample, reflecting only 8% of the cases. Technical violations by public corporations generally involved problems in Reg. A offerings (special securities offerings involving small amounts of capital to be raised which exempt issuers from the full and costly registration process) and general disclosure problems including the filing of annual reports, proxy materials, Reg. A offering circulars and prospectuses, and the like by securities issuers.

Improper Sales Techniques

Improper sales techniques were investigated in about 17% of the cases overall and about 30% of those involving broker-dealers. These offenses fall short of fraudulent conduct but reflect inappropriate sales procedures, primarily by broker-dealers. Most common (5%) is the use of boiler rooms and high pressure sales routines, typically in which the firm has a bank of telephones and salespersons make calls across the country trying to pressure persons to buy speculative stocks. Other activities included in this category are improper supervision of employees, failure to consider the suitability of an investment for a particular client, failure to deliver a prospectus or confirmation of securities transactions to clients, failure to obtain the best price, failure to investigate the stock, employing known securities violators, and the like.

Previous Social Control

Violations based on previous social control essentially involve attempts by parties whose previous offenses and sanctions prohibit them from participating in the securities industry to continue to do so or who fail to disclose this fact. These cases, reflecting 13% of the sample, involve violations of

injunctions, conditions of parole or probation, or SEC bars or suspensions, attempts to cover-up or by-pass these restrictions through the use of fronts or nominees, or failure to disclose previous sanctions in SEC registration materials. About three-quarters of these offenses are committed by broker-dealers.

Securities Fraud

The remaining offense categories to be described are all elements of securities fraud and can be committed by securities professionals and non-professionals alike. They are proscribed by the two most well-known of the sections of the securities acts: Section 17 (a) of the Securities Act of 1933, which states:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly -
> (1) to employ any device, scheme, or artifice to defraud, or
> (2) to obtain money or property by means of any untrue statement of a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
> (3) to engage in any transaction, practice, or course of business which operates or would operate as fraud or deceit upon the purchaser.

and Rule 10B-5 of the Securities Exchange Act of 1934, which states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
> (1) to employ any device, scheme, or artifice to defraud,
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> (3) to engage in any act, practice, or course of business which operates or would operate as a

> fraud or deceit upon any person, in connection with the purchase or sale of any security.

as well as a variety of more specific sections and rules of these acts and of the Investment Company Act of 1940 and Investment Advisors Act of 1940. The most important forms of securities fraud encountered in the sample of SEC investigations are stock manipulation, misappropriation, self-dealing, investment schemes, and misrepresentation. They are considered in turn.

Stock Manipulation

This category subsumes a variety of activities, the purpose of which is to artificially manipulate the market price or trading market of a security, usually to thereby induce others to buy or sell these securities.[18] A characterization of the classic manipulation techniques in the years prior to the creation of the SEC provide some sense for the practice in its most simple and less subtle form.

> The group first secures an option to purchase at a price higher than the then market quotation a large block of a stock which possesses actual or potential market appeal and an easily controllable floating supply. It is the task of the pool manager and operator to raise the market price above the option price, and, if the supply on the market remains constant, this can be accomplished only by increasing the demand. The most effective manner of inducing others to purchase is to have a favorable ticker tape record which indicates to prospective purchasers that others consider the security to be underpriced. The manager opens a number of accounts with various brokers and, fortified by a knowledge of the condition of the market obtained from the book of a specialist, enters both buying and selling orders with a preponderance of the former so that the price is made to rise slowly upon an increasing volume of transactions. In the cruder form of operation many of these transactions will be washed sales in which the

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[18] Sections 9 and 10(a) of the 1934 Securities Exchange Act proscribe a variety of manipulative activities pertaining to securities listed on an exchange; section 10(b) and associated rules prohibit any "manipulative or deceptive device or contrivance" with respect to any security.

> operator is both buyer and seller of the same stock; in others known as matched orders he enters orders to sell with the knowledge that some confederate is concomitantly entering orders to purchase the same amount of stock at the same price. As the price slowly rises, a complex publicity apparatus is set into motion to aid the stimulation of demand: The directors of the corporation whose stock is being manipulated, who may be members of the pool, issue favorable, but not wholly true, statements concerning the corporation's prospects; brokers, likewise interested in the operations, advise customers through market letters and customers' men to purchase the stock; subsidized tipster sheets and financial columnists in the daily papers tell glowingly of the corporation's future; "chisellers," "touts," and "wire-pluggers" are employed to disseminate false rumors of increased earnings or impending merger. As the market price passes the option price, the operator exercises his option and, increasing his sales over purchases, carefully unloads upon the public the optioned stock as well as that acquired in the process of marking up the price. But the operator does not necessarily rest with this gain. If he is able to distribute his holdings, he may sell short, and the stock, priced at an uneconomically high level and bereft of the pool's support, declines precipitately. As it approaches its normal quotation the pool covers its short position, thereby profiting both from the rise which it has engineered and the inevitable reaction.[19]

The common wisdom is that many of the widespread and flagrant abuses involving manipulative activities of this kind prior to and in the early years of the SEC have since been controlled. Whether for this reason or because of investigative disinterest or difficulty, manipulative activity is not a common element of most SEC investigations. One-tenth of the investigations in the sample involved allegations of stock manipulation. And most of these cases involved allegations of other violations as well - 82% involved misrepresentations, 69% securities nonregistration, 33% self-dealing, and 27% misappropriation. The following examples drawn from the sample illustrate the range of stock manipulations investigated.

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[19]From Comment, "Market Manipulation and the Securities Exchange Act," Yale Law Journal 46, pp. 626-8 (1937).

(e) The president of a large corporation engaged in chemical engineering, electronics, and research, development, and the manufacture of rockets had pledged $10,000,000 worth of personally owned stock as collateral for $4,000,000 in loans. He instituted a manipulative scheme in order to support the price of this stock, and thus protect his loan. He caused the corporation to advance money to one of several subsidiaries to purchase its own stock. Stock was only purchased at prices higher than the market price. On some days, his activities accounted for 47% to 86% of the total volume of trading in these corporate securities. These activities continued for about eight months. About $1,200,000 worth of corporate stock was purchased for this purpose.

(f) For two months in 1959, a man in New York purchased over 40,000 and sold over 18,000 shares in a carpet company listed on the New York Stock Exchange. Utilizing accounts with as many as twelve different broker-dealers, he placed matched orders (entering orders to purchase, knowing that there were orders of substantially the same size, same time, and same price for the sale of stock), engaged in wash sales (in which there is no change in beneficial ownership), and effected numerous transactions with a view to raising the price of the stock in order to induce others to buy. He placed purchase orders through brokers at a time when he did not intend to pay for the stock, and allowed brokers to sell him out. This individual was only one of several persons engaged in various manipulative schemes. They were friends and neighbors of the Chairman of the Board of the stock issuer. It was suspected that he had encouraged them to manipulate the stock, that he offered them jobs with the corporation, guaranteed them against losses, and promised a portion of the profits so generated.

(g) Eight New York area promoters and organized crime figures cheaply acquired large blocks of stock of a dormant Florida corporation from substantial shareholders. They then caused it to be merged with a thinly floated public corporation. Through direct purchases, use of nominees, and placing purchase orders without any intent to pay for the stock and honor repurchase agreements, they were able to acquire and tie up most of the floating supply of the corporate stock. For the next two months, they proceeded to manipulate the price of the stock from $2 to $12.50 per share by placing orders in nominee names and not making payment, touting the stock to prospective purchasers, and making buy-back agreements at higher prices with persons who purchased or owned stock. Upon completion of the scheme, the promoters attempted to sell and pledge large blocks of the stock acquired to the tune of $1,400,000. Before they were successful, the SEC suspended trading in the stock.

Misappropriations

The securities context is a marvellous setting for larceny. On the one hand, because investors are purchasing symbolic commodities - interests in some business organization or economic venture - it is possible to construct and manipulate these commodities in ways impossible, for example, in consumer fraud. Furthermore, because securities transactions are based on the promise of some future event or return, it is possible to recruit a large group of investors before future events disconfirm the initial representations. Because of these elements of symbolic rather than physical comodities and inherent temporal distancing, the investment setting is a lucrative one for the swindler.[20] On the other hand, the securities world is populated by a mass of fiduciary roles, necessitated by the requisites of brokering transactions, managing publicly held corporations, and providing investment advice. The fiduciary position can also be exploited for larcenous purposes, particularly for embezzlement and other forms of self-dealing. The former offense is considered here, the latter in the following section.

In the securities context, larceny typically takes the form of the misappropriation of proceeds from securities sales - by stock issuers, brokers, underwriters - or the exploitation of fiduciary relationships, typically by insiders in public corporations and by securities professionals. For twenty-nine percent of all cases in the sample, allegations of misappropriation were investigated, 31% for cases involving only broker-dealers and 26% for those involving securities issuers alone or with broker-dealers. Because of the need to facilitate and cover-up such activities, 88% of these offenses also contained elements of misrepresentation. The following examples illustrate typical misappropriation schemes reflected in the sample.

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[20] See Shapiro 1978b for a fuller discussion of these issues.

The sample contained a substantial number of cases in which promoters created sham or bogus corporations - an investment company, a holding company, a finance company, several mining companies, a company that develops and markets anti-pollution devices, one that develops and markets life insurance and trading stamp vending machines - generated interest in the corporations, and subsequently sold corporate securities to the public, usually without benefit of SEC registration, and usually netting several hundred thousand dollars. Some of the proceeds from securities sales were used to pay promotional costs, to buy props to make the corporation look legitimate (i.e. prototype machines, mining supplies), and the remainder was misappropriated by promoters, either directly or through inflated or fictitious expense claims and the like. In a few cases, where offenders had ongoing relationships with potential victims, the process of creating sham organizations was considerably simplified. A stock broker simply told his clients he was selling some (non-existent) bridge debentures and turnpike bonds. He kept possession of the alleged bonds until maturity, sent phony receipts, and pocketed the monies provided by his clients. A life insurance salesman simply told his customers that he was also selling (nonexistent) securities in the life insurance company and sold $200,000 worth of these bogus securities to his customers.

In some cases, the issuing corporation whose stocks were offered and sold was legitimate. Nonetheless, securities sales provided an opportunity for misappropriation by those so engaged. The president and control person of a corporation which markets his electrical inventions didn't record all stock purchases (especially cash payments) on the corporate books and embezzled these monies (about $50,000). A firm serving as underwriter for three stock issuances did not report all the sales or deposit them in the escrow account, but rather misappropriated the proceeds. In one instance, an issuer audit discovered the

practice and the issuer demanded full payment. The underwriter complied, securing these funds by misappropriating them from another stock issuance.

For several cases, the source of misappropriated funds was not the proceeds from the sale of securities, but rather the operating capital of legitimate public corporations and the recipients of these funds, those in fiduciary roles in the corporations. These practices tended to be more elaborate than simple classic embezzlement schemes.

(h) The president and several of his associates of a loan company abused corporate funds in a variety of ways. They were payed exhorbitant salaries and given generous expense accounts. They were given unsecured loans and large cash advances. They were provided with fancy Cadillacs. A corporate plane was purchased for the purpose of flying the president to various vacation spots and a pilot was hired and put on the corporate payroll.

(i) The general partner of a limited partnership in hotels and motels doubled his salary without authorization; extended himself and other businesses in which he had an interest loans with corporate funds; raised excess funds for the corporation through the issuance of securities and misappropriated the monies so generated; and simply embezzled corporate funds for his benefit and that of other business interests.

(j) Two officers of a corporation which made and distributed motion pictures caused the corporation to issue a check to a corporate client, who in turn wrote a check for $10,000 to a phony bank account. This money was used to buy personal shares of corporate stock for these officers.

(k) Over two and one half million dollars was misappropriated from a credit company by several officers and corporate counsel. These parties sold worthless or considerably overvalued installment contracts owned by corporations which they controlled to the company. They had the company make loans to businesses they controlled, and then paid the interest on these loans with company funds. They had the company transfer corporate funds to a Bahamian bank account which they controlled, and recorded the transaction as simply the opening of a new corporate bank account.

There is a substantial caseload involving the misappropriation of client funds by fiduciaries in the securities profession (usually stock brokers) rather

than in public corporations. The most common forms of misappropriation include instances in which clients order particular stock purchases and remit the necessary payment, which the broker converts to his own use without purchasing the securities; brokers utilize client stock certificates held in safekeeping as collateral on personal loans or simply forge client signatures on the stock certificates, sell them and convert the proceeds to their own use (also called "bucketing"); brokers misappropriate funds in customer credit balances or, without authorization, close out a customer's account, taking the check made out by the firm to the customer, forging the endorsement and depositing proceeds in the broker's personal account.

Rather than abusing client assets for personal gain, characteristic of the previous examples, brokers may generate additional personal revenue at their clients' expense. They may charge excessive and unreasonable prices for securities purchased or unreasonable mark-ups or commissions. They may churn a clients' discretionary account, engaging in excessive and unnecessary trading to generate larger commissions. They may engage in interpositioning, a collusory practice among firms, in which brokers do not transact with the market maker for a particular stock where they can get the best price for a customer. Rather, they purchase the stock at higher prices from other brokers, allowing them to absorb the benefit of the good trade. Interpositioning brokers collude in this fashion because of the bribes or kickbacks generated by the practice.

Practices of this kind which involve stealing client assets or overcharging them are often supported by rather elaborate cover-up techniques. They include sending fictitious confirmations of stock transactions, paying phony dividends out of one's pocket for (nonexistent) stocks which the client thinks are being held in safekeeping, persuading clients to leave stocks and bonds with the broker for safekeeping, urging clients to allow their (nonexistent) investment

profits to remain with the broker for reinvestment, paying clients who demand payment with funds of other clients (i.e. "robbing Peter to pay Paul"), falsifying books and records of the brokerage firm, and the like. One broker overpaid on his income tax return to cover-up his behavior, came to work early to intercept the mail and remove any letter that might reveal his activities, and when a victim died, would shuffle around the accounts so that the victim's estate would not learn of his misappropriations.

The opportunities for misappropriation are so great for persons in fiduciary roles, particularly those vested with discretion, that some fraudulent schemes involve the creation of fiduciary positions or trusting relationships as a fundamental strategic component.

(1) In 1958, a railroad worker convinced five acquaintances and neighbors to join an investment club, of which he was made President. Members paid $50 monthly fees to the club, and in two years, their ranks had swelled to ten and their accumulated dues to $24,000. Because of their trust and confidence in his knowledge of the market, the President was given complete discretion and authorization to purchase securities through his own brokerage account. He maintained complete control of monies contributed, and told investors that for the sake of convenience, all securities purchased would be held in his name. Members never saw the stock certificates. The president periodically informed members that he had made various transactions on behalf of the club. None of the stock was in fact purchased. Instead, he utilized the monies to cover his personal losing stock transactions and to pay personal expenses (some club checks were cashed in the local grocery store, for example). Two years later, the president skipped town. Investors lost everything.

The ex-president next went to Miami, where he befriended an elderly couple, and accompanied them to their home in Michigan. By giving them stock tips, he induced them to switch their stocks for his own in various issuers. He cashed their securities, said he was going to Chicago to get his certificates, and never returned. After a two month acquaintanceship, the couple had lost $11,000.

The ex-president later met two men in Chicago. They entered into separate oral agreements to mix $4,000 and $5,000 respectively, with his own money for the purchase of

securities. When they asked for their money back, he said that he had to use it to cover financial setbacks. After pressure from their attorneys, he executed a promissory note, on which he defaulted.

(m) An Iowa stock broker, previously involved in other misappropriation schemes, sold investment contracts, consisting of an interest in a securities trading account. He represented to investors that he had technical knowledge of the operation of the stock market and could make substantial profits. He would invest money in stocks and bonds, allegedly put the money in trading accounts, and divide the profits with investors. He indicated that investments would be safe, and promised a monthly return of 3%. He wrote letters to investors stating that he was following the market daily, had traders working for him in Chicago and New York, that capital had appreciated greatly and was earning a great deal. He paid monthly returns to certain investors and even increased returns to indicate how well his trading was progressing. However, there were no trading accounts set up and he was converting all the monies (less the phony dividends) to his own use.

It is only in the context of broker misappropriations that investigatory materials provide any insights about the motivations for participation in securities violations. These include the typical rationalizations for embezzlement: the expenses generated by divorce, alimony, and family illness; repaying loan sharks for gambling debts; living beyond one's means or extravagant living; liquor and cabaret bills; gifts for a cabaret performer; purchase of a new home. The sole proprietor of a broker-dealer firm misappropriated funds in an attempt to save his insolvent firm. The officers of a stock issuer argued that misappropriated funds were needed to pay a bribe to foreign officials to get oil concessions (these allegations could not be substantiated). For some, the motivations were presumably more psychological than situational. Two embezzlers were subsequently committed to mental institutions by their families, two others committed suicide. Some more unique contingencies for misappropriation are afforded by the speculative nature of investments. Several brokers needed money to cover personal market speculations

and losses in a commodity account. One broker lost substantial amounts of money for clients through discretionary commodities investing and engaged in embezzlement to pay them back. One salesman lost $13,000 for his firm when he pushed a particular stock and many customers cancelled their purchases. He was a mediocre salesman and feared losing his job, so he misappropriated funds to reimburse the firm.

Self-Dealing

Offenses reflecting self-dealing are very similar to those involving misappropriation, particularly that by fiduciaries. Indeed, some of the illustrations provided in that section had elements of self-dealing. What is central to the self-dealing offense is that it reflects the exploitation of insider positions for personal benefit. But the nature of personal benefit is more than simply the embezzlement or expropriation of funds. It may reflect the allocation of corporate commodities or contracts to businesses in which the insider has an interest, the direction of corporate discretion in favor of one's personal interest, the use of organizational resources to create new opportunities that one can exploit, or the use of non-monetary corporate resources or information for personal advantage. Fourteen percent of the cases in the sample had elements of self-dealing. This section considers three kinds of self-dealing most common in investigated securities violations, the first, general kinds of self-dealing by insiders in public corporations, the other two involving different forms of insider informational exploitation, insider trading and scalping. A few examples provide a general sense for the typical self-dealing situation encountered in an SEC investigation.

(n) Several directors of a registered investment company entered into an arrangement with the custodian bank of the investment company, whereby its funds would be used as a means of providing loans and credit for these persons and

for companies in which they had a financial interest. They later informed the bank that as a condition of continued business, the bank must maintain correspondent accounts in four other banks, from which they then made substantial borrowings. To facilitate these loan transactions, the directors caused the investment companies to maintain excessive cash deposits with the banks.

(o) A Chicago man ran a private sole proprietorship which was in the business of manufacturing arc welders, torches, cutting, and filing tools. He had the business incorporated and became a major shareholder and control person. He used the corporation, however, for his own financial benefit, netting himself a great deal of money and depleting corporate coffers until its eventual bankruptcy. For example, he bought metal at 5 cents/pound, sold it to the company for 27-38 cents/pound, which then processed and sold it, though unable to make a profit. He created other personal companies that would process corporate products at great profit without performing any worthwhile function - for example, buying saws from the corporation at $8.50 and selling them for $16, utilizing corporate resources to make the distribution.

(p) This case involves a corporation doing lettuce and potato farming in Texas and Colorado which never operated profitably and continuously had to borrow. Corporate officers consulted with a North Carolina broker-dealer about underwriting a possible stock offering. Instead, they formed a new North Carolina corporation to sell shares of its own, the alleged purpose of which was to invest in farm equipment and farm properties. Actually it acted as an unregistered investment company. Investors were not informed that it was lending substantial sums to the potato/lettuce corporation. Indeed, all the issuer did was lend money to the lettuce firm and others in which its directors had an interest. Many of the directors never attended board meetings. They failed to supervise, scrutinize, and direct. Many were receiving pecuniary benefits from the lettuce corporation at the same time they were extending loans.

In the insider trading case, insiders of public corporations abuse information available to them by virtue of corporate position rather than abusing economic assets as in the previous examples. They utilize this information in making personal investment decisions to the disadvantage of parties with whom they trade who lack such information. Three examples of insider trading by corporate officers, corporate employees, and stock brokers

illustrate the range of opportunities for this kind of abuse.

(q) A corporation was engaged in Canadian mining explorations, and several corporate insiders had seen the drilling results and were aware of some promising land on which exploration was being conducted. They decided to keep the prospects secret, as they wanted to purchase the land at reasonable terms. During this period, rumors were circulating, and the price of the stock was rising (as were those of all mining stocks) and trading was very heavy. Corporate management was concerned with the trading situation and issued a press release which they hoped would diminish interest and expectations concerning the stock. The release qualified and dampened corporate prospects with regard to these explorations. Four days later, they issued a glowing press release, announcing a major discovery of ore. The result of the first release was to lower stock prices, and of the second, to increase them. Corporate insiders had been trading on inside information since the first favorable reports seven months earlier, but particularly during the interim between the press releases, and had been tipping to their associates. No disclosures were made to the sellers with whom insiders transacted. Insiders and tipees made profits from these transactions of $148,000.

(r) A plant superintendent of a securities issuer was conducting representatives of another corporation on a plant tour, when he overheard rumors of a possible merger. He then purchased 480 shares at $48.50. Two days later, a merger between the two corporations was announced, and his stock appreciated to $75/share. The superintendent claims that he made the investment because it seemed like a good speculation and was surprised by the merger.

(s) A registered representative of a New York brokerage firm also served on the board of directors of a public aircraft corporation. At a board meeting he learned that the corporation was going to cut its dividend. During a break, he phoned a partner of the brokerage firm which employed him and informed him of the decision. The partner, knowing that such information had not yet been released to the public, executed orders to sell 2000 shares for ten accounts and sell short 5000 shares for eleven accounts, including those of some clients of the director and that of the partner's wife. About $42,000 in profits accrued from these transactions, the greatest profit asbsorbed by the partner's wife.

The final example of self-dealing involves abuse of information, but of a different kind than in insider trading. In insider trading offenses, parties

react passively to information. In "scalping," offenders play a more active role with respect to information; in some sense, they create it and then exploit it. In scalping, a party touts a security after first taking a position in the particular security and then takes advantage of the ensuing market reaction to the touts.

(t) A New York investment advisory firm publishes advisory material to which members of the securities industry subscribe and also provides a supplementary consultation service through which it disseminates oral recommendations to broker-dealers. Two research analysts of the firm purchased stocks prior to recommendations to clients of these services to purchase these stocks, and resold them for a profit in the market they had created. They never disclosed their holdings to clients of the firm. Together they made profits of $39,000.

Investment Schemes

Investment schemes have many of the elements of securities fraud - particularly misrepresentation (88% of them), registration violations (70% of them), misappropriation (48% of them), and manipulation (22% of them). However, unlike many of those offenses in which an attempt is made to provide a viable investment opportunity or service, investment schemes typically are designed from the beginning as con games or larceny schemes set in an investment context. Only 8% of the cases in the sample were classified as investment schemes. The following examples pertain to the two most common kinds of schemes, Ponzi games (2% of all cases) and shell corporation swindles (3% of all cases).

(u) A California man represented to investors that he could buy electronic component parts at exceptionally low prices at auctions, government surplus sales and from bankrupt companies, and later resell them at huge profits. To support this, he falsely stated that he held a degree in electrical engineering from an eastern university, that he had held responsible positions with several large electrical companies, and that these and other connections with the electronics industry enabled him to dispose of electronic component parts at great profits. He would represent to

potential investors that his need for money resulted from the exhaustion of his personal funds and the difficulty of obtaining bank loans because of the type of items being purchased. He represented that as investment opportunities presented themselves, he needed money for various periods of time, and that because of the substantial profit made on each transaction, money invested with him for short periods of time would yield huge profits to the investors. In exchange for the money, he issued each investor his personal promissory note for both the principal amount invested and a profit of 40-70%. Investors looked solely to him to manage their investment. During the progress of the scheme, he had frequent meetings with the investors, where he outlined the program, gave them the choice of being repaid, taking out part of the money, adding additional amounts of money, or letting their money ride for another investment period. Because of his readiness to pay off those desiring their money back, the majority of the investors would often leave their money with him. Proceeds from the sale of these promissory notes and investment contracts were not applied to the purchase of electronic parts, no profits were realized, and payments made to investors were derived from the paid in capital resulting from the sale of additional securities to investors. In this particular case (he was involved in others), at least fifty to sixty persons in the Salt Lake City area invested between a quarter and a half million dollars during a ten month period. The scheme ended when he was indicted by the state of California for a similar scheme.[21] (ponzi game)

(v) Two promoters acquired control of two dormant Arizona shell corporations with no assets, issued stocks to themselves for no consideration, and bought up shares of its old shareholders for 1 cent apiece. They enlisted the aid of brokers in creating a market for, manipulating the market price of, and distributing this unregistered stock to the public. Facilitators of the scheme included promoters, broker-dealers, a transfer agent, conduits for the movement of shares, and nominees. The following month, a dinner meeting was held for brokers and investors to interest them in the issuer, describing its numerous (nonexistent) operating divisions, its assets (which were actually valued at only $500), and plans for future mergers and acquisitions. Within about ten months, more than 2,000,000 shares had been transferred from insiders to the public, netting somewhere between one and a half and seven million dollars. (shell corporation swindle)

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[21] The typical ponzi game collapses because more money is being paid out as fallacious dividends and as misappropriated funds than is being taken in as new investment capital.

The last example in the manipulation section also reflects the use of shell corporations in manipulative schemes.

Misrepresentations

By far the most common element of securities violations is that of misrepresentation. For two-thirds of all cases in the sample, allegations of misrepresentation were investigated. For a minority of these cases (7% of all misrepresentation cases) allegations of illegality pertained only to misrepresentations. For the majority of cases, one or two other forms of illegality were alleged as well. This derives from the fact that misrepresentations are central to the facilitation or cover-up of most offenses - for example investment schemes, misappropriation, self-dealing, manipulation - and that other offenses may insure the success of misrepresentational schemes. For example, registration violations, because they hide the scheme from the purview of the SEC, may be a cover-up strategy to diminish the likelihood of agency intervention. Each of the offenses listed above are therefore strongly correlated with the use of misrepresentations in illegal activities.

The coding scheme (Appendix A) lists more than fifty different kinds of misrepresentations employed in the course of securities violations. They have been distilled to seven different categories, plus a general category, described in further detail in Appendix D. Misrepresentations pertain generally either to characteristics of the corporation issuing the securities or to the particular security offering. The former include misrepresentations about (1) the status of the corporation - its business operations, financial condition, assets, resources - about (2) the future of the corporation - its prospects and risks - about (3) corporate insiders - their background, compensation, financial interests, self-dealing - and about (4) corporate oversight - its registration with the SEC or self-regulatory organizations. The latter include

misrepresentations about (5) the offering itself - the source of stock, the kind of stock, the size of the offering, the current market value of the stock, the market for the stock, etc. - about (6) the role of the broker-dealers in the offering, their compensation, etc. and about (7) the return on investment - dividends, future prices, repayment of bonds, etc.[22]

Most offenses of this kind employ more than one kind of misrepresentation of the 59 odd categories in the coding scheme. The median number is six; one offense utilized fourteen different misrepresentations. Furthermore, as the previous footnote indicates, some kinds of misrepresentations are more popular overall than others. The most common single misrepresentations reflecting 28% of all cases in the sample and 42% of all offenses employing at least one misrepresentation, pertains to corporate financial condition. And the popularity of particular categories of misrepresentation varies by the constellation of other elements of the offense. Misrepresentations about corporate status are most common for offenses also involving securities nonregistration, misappropriation, and investment schemes; those about corporate insiders, most common with self-dealing, technical violations, and improper sales techniques; those about the stock offering, most common with securities nonregistration and misappropriation; those about investment return, most common with improper sales techniques, securities nonregistration, investment schemes and misappropriation. In short, in order to consummate various kinds of swindles, different forms of misrepresentation are required. The typical content of high pressure boiler room sales pitches pertains to future corporate prospects and investment return, and the data indicate those are exactly the most popular kinds of

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[22]Misrepresentations about (1) corporate status were found in 46% of all offenses, about (2) corporate future in 30%, about (3) insiders in 21%, about (4) oversight in 10%, about (5) the offering in 38%, about (6) the broker-dealer's role in 7%, and about (7) return on investment in 27% of all cases.

misrepresentations associated with offenses of this kind. Similarly, in self-dealing schemes, offenders attempt to conceal their activities by misrepresenting the identities and outside interests of insiders; and, indeed, that is the only kind of misrepresentation positively associated with offenses of this kind.

It is difficult to illustrate the range of offenses in which misrepresentations figure, because it is so great and the population of cases so disparate. However, the following samples do reflect some of the typical contexts in which misrepresentations occur:

(1) in the initial offering and sale of corporate securities;

(w) This case involves a Mississippi corporation engaged in the loan and discount business. It printed up a brochure and placed ads in newspapers in several states offering 8% interest on investments which were guaranteed up to $20,000 by a second corporation with a separate certificate of guarantee. The second corporation received no consideration from the stock issuer for guaranteeing its notes. The guarantee was obtained through oral agreement. The names of the corporations, their emblem, and their promotional materials were made to resemble that of the Federal Deposit Insurance Corporation (FDIC). The guaranteeing corporation had almost no assets, that of the stock issuer included only a car and notes from lenders. The monies obtained from investors were transferred to a Mississippi bank and loaned to bank employees in southeastern states. These were unsecured loans for a maximum of $3,600 with a three year maturity. No credit checks were made on loan applicants nor were financial statements obtained. The misrepresentations made to investors included:

- that the issuer has been in business for nine years and has eight offices
- that the issuer has been paying 10% interest on similar investments for five years
- that notes issued are like certificates of deposit
- that all accounts are guaranteed up to $20,000
- that the issuer is paying the highest interest rates in the nation
- that they had SEC approval
- that they were opening offices in other states
- about the financial condition of the corporation
- about the riskiness of the investment

Representations failed to disclose that the guarantee afforded no protection because the second corporation had insufficient assets. They also failed to disclose that the second corporation was not licensed as an insurance company. At least $74,000 was raised from investors in this scheme.

(x) This case involves the promotion of a venture for cargoing fresh produce by air from the Seattle area to Alaska. Funds were being raised by the sale of securities in a Washington corporation. The promoter was trying to raise $300,000 for the purchase of aircraft and produce and to finance the operation. He placed newspaper ads for pilots, mechanics, and cargo handlers, but made investment a criterion of employment, and utililzed this strategy as a means of facilitating security sales. The misrepresentations made to investors included:

- that the company had established markets in Alaska
- that the company had been in business for two to four years (actually only two months)
- that the company owned six planes (actually it had none)
- that the company had complied with FAA requirements
- that the company had applied to register its securities
- that past operations of the company had been profitable (there had been no past operations and an earlier company controlled by the promoter had been totally unprofitable)
- that the promoter had invested up to $180,000 of his own funds in the company (had actually invested nothing)
- that several financially well known persons had invested funds in the corporation
- that employees must invest in the company and only employees are permitted to invest
- that the investors' money would be returned at any time

About $25,000 was obtained from eleven investors.

(y) A former private eye and his son began acquiring oil and gas leases in lands in Nevada from the Bureau of Land Management and offering to sell assignments through magazine advertising and direct mail solicitation. They then formed a second corporation to act as an operating company for developing and drilling the oil leases, and solicited stockholders to switch over their leases to utilize these drilling services. At least 30 persons invested $500,000 in these companies. The misrepresentations made in securing these investments included:

- that an oil field had been discovered in Nevada

and a full blown oil boom was a reality (actually only about one-nineth of the wells drilled had any oil)
-that every known oil province in Nevada is leased to the hilt and that these leases are in the center of these fields
-that oil producers are coming to Nevada in masses because of these findings
-about the drilling activities of major oil companies in this area
-that the principals were spending half a million dollars on drilling, indicating their faith (they fail to mention that it's public money that has been spent)
-they misrepresented the test results
-that they are helping the little guy by making small patches available
-that if oil is discovered, it will be the largest boom in the nation
-that investments bear little risk
-that an investment of $11,400 would net $14,000 per year if a modest well were drilled
-about the nature and extent of oil reserves in Nevada
-about oil production and the capacities of particular wells
-about the probability of successful drilling
-about the profits to be earned from drilling efforts
-about the cost to these promoters and the amount of money they have invested in the company

(2) in the initial offering and sale of the securities of a brokerage firm;

(z) A Washington state brokerage firm was in need of cash to repay funds to a stock issuer from whom it had misappropriated funds when underwriting its offering. In order to get these funds, the brokerage firm offered its own stock to the public and eventually collected $85,000 from more than one hundred investors. The misrepresentations it made to the investors as well as to the SEC in its registration materials concerned:

-the experience, background, and previous activities of the firm
-its profits
-its assets and their value
-its underwriting commitments
-its financial obligations, neglecting to mention its monthly losses since its inception
-its standing and leadership as a broker-dealer engaged in industrial financing in the state of

Washington
-about the existence of a market for its stock
-about the increasing market value of its stock, failing to indicate that they had created the market
-about a guaranteed return on the investment and dividends to be paid
-about the listing of the securities on a national exchange
-about the number and location of corporate offices
-about the use of proceeds from stock sales
-about the offering, that the state of Washington had allowed them to withdraw their offering and raise the price of the securities because they were worth more
-about compensation to insiders, neglecting to state that they had invested little in the firm

(3) in subsequent attempts to sell outstanding corporate securities by broker-dealers;

(aa) This case involves the fraudulent sale of shares in a Montana mining company by a New York broker-dealer. The fraudulent promotion was simply a market operation. It did not involve the sale of stock on behalf of the issuer; all shares were outstanding. The fraudulent misrepresentations were contained in several pieces of literature which were widely distributed. Investors were also contacted by high pressure salesmen by telephone either before or after the mailing. Paid ads appeared in New York newspapers. Among the misrepresentations made in the sale of these securities include:

-that the stock was authorized but unissued stock
-that the company owned a certain mine
-that the mines had a proven and substantial value
-that equipment and machinery installation was near completion
-that an assay report placed yearly net income at $1,500,000
-about estimated earnings
-that the mine would open in sixty days
-that the stock price would increase
-that proceeds of the stock sale would go to the issuer
-that the firm would repurchase the stock

Salesmen failed to disclose that the mine had been inactive since 1925 and that substantial equipment had been removed, that large portions of the mine were inaccessible because of caving and flooding, that the engineering reports described

were made in 1920, and that engineers now said that mining was not feasible. The brokerage firm had been formed exclusively to push this security. The firm sold about 800,000 shares at 30-35 cents at a time when the over-the-counter price was 16-20 cents. They had acquired the stock at 3-21 cents.

(4) in attempts to purchase corporate securities;

(bb) This case involves fraudulent purchases of the stock of the minority shareholders of a large southern insurance company by the company's principal officers and directors, who induced uninformed public stockholders to sell out at grossly inadequate prices. The scheme was effected by the misrepresentation of material facts, active concealment of such facts, and non-disclosure of material inside corporate information which they were obligated to disclose in soliciting the stock. Principals never sent financial statements to stockholders or paid dividends to disclose the good financial condition of the company. They concealed the fact that stock holdings were being acquired for the principal corporate officers, instead alleging that they were for persons opposed to management including a man who wanted to get on the board to force the payment of dividends. They misrepresented the value of the stock and the existence of a market for the stock. The purchase of these shares was facilitated by direct solicitations by these parties under assumed names, through nominees or with the assistance of broker-dealers. As a result of these efforts, the principals acquired thousands of shares of stock at grossly unfair prices and then negotiated an agreement with a securities underwriter to sell the shares at a price greatly in excess of what they paid. As a result, as many as 250 public stockholders lost in excess of $100,000 (based on the market value of the stock at the time of purchase).

(5) in routine disclosures of a public corporation unrelated to attempts to buy or sell securities;

(cc) This case involves a public corporation which finances and "factories" industrial enterprises, which was in a hopelessly insolvent condition and whose chance for continuing in business was dim. However, it was able to secure loans totalling more than three million dollars from thirteen different banks. This was possible through the preparation of false and misleading financial statements certified by a CPA firm, and included in its SEC 10K annual reports for two different years. Balance sheets and

financial information classified assets as current when they were not current at the time, and significantly overstated current assets. It also failed to reveal the subsidiary status of certain companies classified as customers. The CPA firm knew or should have known of the various discrepancies.

(6) and in the promotion of professional services in the securites industry;

(dd) Several cases involved misrepresentations by investment advisory services to potential clientele about the quality of the service they offered. One firm utilized a Wall Street address as a mail drop, and listed on its letterhead a number of well known financial books and authors, implying that these persons were employed members of their advisory staff, when they were not. Misrepresentations concerned:

- the size of the company
- its financial condition
- its facilities for service
- the background and experience of personnel
- the success of its advice to clients
- about assurance of profit
- about the selectivity of clientele
- that information is confidential and preserved by copyright
- that wealthy persons number in their clientele
- that no other advisory service has a better record
- that it provides an in-depth independent analysis, when actually all it reflects is an editing of reports provided by the companies being touted
- that the graphs provided will zero in on the market winners, failing to disclose the limitations on these predictions
- about the limited number of subscriptions available, and about the urgency for readers to subscribe.

Offense Constellations

Within the previous descriptions of the general categories of illegality an on-going discussion of the interrelationship of types of offense can be found, the major theme of which is that different activities help serve to cover-up or facilitate the successful consummation of a course of illegal conduct. Within that discussion, some of the major correlates of a particular offense type were enumerated. This section attempts to systematize some of these findings.

For any general category of offense, it is more likely that investigation will pertain to additional violations than that it will examine this violation alone. Indeed, the only offense categories for which more than a quarter of the violations are self-contained, lacking other offense correlates, are broker-dealer technical violations (29%), misrepresentations about investment advice (29%), and violations based on previous social control (28%). For some offenses, like registration violations by professionals, misappropriation, and stock manipulation, this percentage is less than 3%.

If inter-offense correlations are so dramatically the norm, the problem becomes how one can describe and disentangle these correlations, these offense constellations, given literally thousands of possible combinations. The solution presented here is superficial, but coupled with some of the more detailed 2-way correlations presented as part of the ethnographic descriptions, is adequate. It collapses a few of the offense categories and cross-tabulates the most frequent offense occurrences: registration violations, technical violations, and the elements of securities fraud including misrepresentations, misappropriations, self-dealing and stock manipulation. This cross-tabulation is presented in Table 4.8. Only raw frequencies are provided, since so many different percentage bases are relevant.

There are so many findings to be mined from the table that it is impossible to present them all. The role of misrepresentations as a correlate of registration violations and particularly of other elements of securities fraud is, of course, apparent. The ratio of these offenses coupled with misrepresentations to that of those occurring without misrepresentations ranges from 2.8 for registration violations to 5.9 for misappropriations. Although technical violations are more likely to occur with other offenses than alone, the degree of correlation is much lower. The ratio of its joint occurrence with

TABLE 4.8: OFFENSE CONSTELLATIONS (Cell Frequencies)

	None	Manipu-lation	Self-Dealing	Manip. & Self-Deal	Misappro-priation	Manip. & Misap.	Self-Deal & Misap.	Manip. Self-Deal, Misap.	Total
NO MISREPRESENTATION									
None	(4)	(2)	(8)	(2)	(3)	(0)	(0)	(0)	19
Registration Violations	(52)	(5)	(1)	(0)	(2)	(0)	(0)	(0)	60
Technical Violations	(85)	(0)	(2)	(0)	(17)	(0)	(0)	(0)	104
Registration & Technical Violations	(9)	(0)	(1)	(1)	(3)	(0)	(1)	(0)	15
TOTAL	150	7	12	3	25	0	1	0	198
MISREPRESENTATIONS									
None	(30)	(5)	(7)	(2)	(12)	(0)	(8)	(1)	65
Registration Violations	(75)	(10)	(4)	(4)	(44)	(5)	(6)	(0)	148
Technical Violations	(23)	(0)	(8)	(1)	(18)	(1)	(3)	(2)	56
Registration & Technical Violations	(23)	(5)	(1)	(3)	(18)	(4)	(3)	(2)	59
TOTAL	151	20	20	10	92	10	20	5	328
GRAND TOTAL	301	27	32	13	117	10	21	5	526

misrepresentations to its occurrence without misrepresentations is 0.97, with registration violations and misappropriations, 0.46. Whereas stock manipulation is most likely coupled with registration violations (the ratio is 2.4), this is not the case for self-dealing (ratio 0.61). The most common three-way offense constellations involve misrepresentation, registration, and misappropriation (N=82, 16% of all cases), misrepresentation, technical violations, and misappropriation (N=51, 10% of all cases), and misrepresentation, registration, and technical violations (N=59, 11% of all cases).

Other Characteristics of Securities Violations

The analytic needs of the research require more data on securities violations than simply the generic elements of illegal conduct, of course. They include data on the means by which activities are implemented, the duration of the activities, their impact, as well as the social context in which violative conduct was located. Each of these dimensions reflect sets of variables on which data were collected. Most of the social context variables were described in the previous discussion of offender characteristics, the other variables are described later in this chapter. A full sense for the nature of illegal conduct is provided by the simultaneous evaluation of these variables with that reflecting the elements of illegal conduct just considered.

The Media of Illegality

Some of the ethnographic offense descriptions included discussion of the means by which the offense was executed, for example, the use of nominees or the creation of phony records. This section considers more systematically these media of illegality. For three-fifths of the cases in the sample, it was meaningful to distinguish particular offense media. These included professional to client communication (20% of all cases), oral representations (43%),

prospectus type materials (24%), annual and other status reports, financial statements, proxy materials (12%), special SEC applications or filings (10%), investment related literature, documents, sales brochures, opinion letters, correspondence (29%), advertising, public relations (12%), articles in the press (4%), corporate books and records (9%), securities transactions confirmations (2%), nominees, dummies, fictitious persons (12%), stock market data (4%), and props, phony machinery, planted gold specimens, etc. (2%).[23]

Not surprisingly, media vary by type of offense. For example, the manipulation and falsification of books and records (16% vs. 4%), the use of professional to client communication (25% vs. 10%), the use of special filings (16% vs 4%) and the use of stock confirmations (4% vs. 0%) are much more likely for technical violations by broker-dealers than for other forms of offense. Clearly these kinds of media are inherent in brokerage transactions and in the substance of SEC inspections. Most broker-dealer technical violations will involve either the records it keeps, the materials it files with the Commission, or its oral or written communication with clients. The distinctive problems of enacting registration violations involve the need to find investors and secure their commitment without utilization of the formal channels afforded by registration - registration statements, exchange listings, etc. So we find that those media distinctive of registration violations involve more disembodied or non-public forms of communication: oral representations (45% of registration violations vs. 13% of cases without these violations), sales literature (29% vs. 19%), and advertising (13% vs. 3%).

Victimization

Some of the offenses investigated by the SEC do not generate victims, for

[23]The sum of these percentages exceed 100 because 37% of the cases utilize more than one strategy to execute illegality.

example, certain technical or registration violations. However, about two-thirds of the investigations pertained to offenses for which there were victims. As discussed more fully in Chapter 2, data on victimization are of only moderate quality, since these materials are not always salient to SEC investigators and therefore not always included in the investigative record. However, data on victimization were available for slightly over 200 cases - about three-fifths of those offenses which generated victims. These data are considered in this section.

Unfortunately the underreporting of victim data produces a serious bias that must be considered at the outset. The most common circumstances under which victim data will be generated are where SEC investigators must interview victims or where victimization is utilized to justify a particular (usually criminal) prosecutorial response. For many offenses where victims are unwitting or were uninvolved in the execution of illegality, victims would have no useful information to provide investigators. Thus, where corporate shareholders are victimized by officers engaged in self-dealing or by others manipulating their stock, it is unlikely that they would be included in investigation. On the other hand, where victims are stock purchasers who were defrauded by brokers and promoters in stock sales, it is likely that their testimony would be solicited by SEC investigators. These data may be biased, then, in over-representing offenses in which victims play a more "dynamic" role in the course of illegal activity.

Offenses are rather different in the patterns of victimization they create. Some touch only a few persons, some thousands. Offenses differ as well in the strategies by which victims are recruited, their relationship to offenders and to each other, their sophistication, and the like. The diversity in numbers of victims is displayed in Table 4.9:

TABLE 4.9: NUMBERS OF VICTIMS

	(N)	%
Less than 5	(23)	11%
5-10	(17)	8%
11-25	(30)	15%
26-50	(42)	21%
51-100	(29)	14%
101-200	(21)	10%
201-500	(17)	8%
501-1000	(6)	3%
1000 +	(12)	6%
Don't Know	(6)	3%
Total	(203)	99%

Numbers of victims reflected in the research sample range from one or two to ten thousand, although the median category is 26-50 victims. These data characterize offenses in a somewhat different light than the public stereotype of the SEC case. Although a dozen cases did involve several thousand victims, consistent with the stereotype, this is indeed a rarity. Another unexpected finding pertains to the geographic distribution of victims. For 12% of the cases, all victims came from the same city and for 32% from the same state, this despite the assumption that SEC jurisdiction is typically interstate.[24] For only about two-fifths of the cases did victims reflect more than a single geographic region. Thus, the typical investigation is a bit less cosmopolitan in size and scope than one might expect.

Victims of offenses in the sample are overwhelmingly individuals. Only 8% of the cases generated victims which included organizations in their number. Furthermore, victims are predominantly stock purchasers at the time of their

[24]The SEC has jurisdiction over intra-state fraudulent conduct. However, often these matters are felt more appropriate for the purview of state investigators.

victimization. In 80% of the cases, they were purchasers, in 3% sellers, in 11% investors or clients (i.e. of brokers or investment advisors), and in the remaining cases, they were shareholders or some mixture of the previous roles. Note that these latter findings pertaining to the predominance of individuals and of purchasers as victims as well as of small localized victimizations are probably affected by the data biases described previously.

I attempted to collect data on background characteristics of victims - their wealth, sophistication, etc. Unfortunately, the extent of missing data on these variables was greater than the amount of data available. We find a few very wealthy and very sophisticated victims, a larger number of middle class and casual or novice investors. And we find a group of victims significant less in their number than in their considerable naivete and gullibility - investing in gold mines with phony ore planted at the entrances, dry oil wells, airplanes that can fly without wings, fantastic cancer cures and diet remedies, excursions seeking sunken treasures, machines that turn sand and gravel into gold, and other questionable business enterprises.

Somewhat more reliable and really quite fascinating data pertain to the way in which offenders recruit their victims, their prior relationships, and prior relationships between the victims themselves. Table 4.10 displays the prior relationships between offenders and victims. These categories are very heterogeneous. The category of "strangers" includes persons who simply reply to newspaper advertisements, who own stock in a corporation, the offending officers and directors of which they never meet, who buy or sell stock through market mechanisms and never meet insiders with whom they are transacting, who are solicited to buy stock over the telephone by high-pressure salesmen engaged in a boiler room operation, who become marks of con men and who may ultimately spend considerable amounts of time together before the victimization is consummated.

TABLE 4.10: PRIOR VICTIM-OFFENDER RELATIONSHIPS

	(N)	%
Strangers	(81)	40%
Some Relationship	(25)	12%
Professional/Client	(20)	10%
Family, Friends	(19)	9%
Mixture	(35)	17%
Don't Know	(23)	11%
Total	(203)	99%

The "some relationships" category includes fellow employees, employees and employers, business associates, teachers and students, doctors and patients, acquaintances, members of the same church or association. The "professional/client" category is more homogeneous, composed primarily of stock brokers and their clients and an occasional lawyer/client relationship, as is the category of family and friends. The degree of intimacy of prior victim-offender relationships was a bit surprising. Family victims are not always "great Aunt Tillies" who have not been seen in 20 years; they include parents, siblings, in-laws, and closest friends.

Perhaps the most interesting finding emerging from the table is the unexpected number of cases (48%) in which victims and offenders are not strangers, a proportion even higher than that of strangers. And as we will learn shortly, even the victimization of strangers is sometimes facilitated by the fabrication of fraudulent intimacies and temporary relationships. Although the number of victims decreases as interpersonal intimacy increases,[25] the quantity of really quite intimate relationships is surprising. This conflicts

[25]The percentage of offenders with less than 100 victims (72% of all cases) increases from 53% where victim and offender are strangers, to 89% for family and friends, to 94% for clients, to 96% for prior relationships.

with stereotypes of white collar crime in which a chasm of interpersonal distance, disembodied transactions, cover-up techniques, middlemen, records, documents and computerization are thought to permanently separate victim and offender.

A first reaction after examining the table is of a rather insidious securities offender seeking out and victimizing his or her closest friends and family members, or creating and exploiting relationships and social networks for personal gain, of the securities violator as the classical con man roping and cultivating his mark. And this reaction is not entirely fallacious - one finds some of this in the SEC investigative caseload. And one finds bits and pieces of a largely untold story of the victim as mark, of the victim who transacted with acquaintances and intimates, and of the psychological trauma created by that betrayal.

But there is another reality that underlies some of these statistics, of an unwitting securities violator, who develops a new business venture, who naively evades the SEC registration requirements, who, in enthusiasm puffs or misrepresents the nature of his business and of investment prospects, and who - out of a need for quick capital despite few connections, and out of a desire to share these great opportunities with those he cares about most - turns to those around him for investment capital. Intimates and associates become the benefactors of ultimate securities swindles because of their accessibility and of their willingness to become involved.

Of course, there is another side to this coin, reflected in the ease of recruiting victims and consummating transactions with them as the social distance between victim and offender are lessened, as well as of the ease of recruiting multiple victims by tapping into ongoing social networks.[26] In some

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[26]For a discussion of some of the more generic elements of designing fraudulent

of the offenses reflected in the sample, one finds contrivances by offenders to reduce the social distance between themselves and potential victims. In several cases, offenders masqueraded as traveling clergymen, missionaries, and the like, moving from town to town, attending the local church for several weeks, and soon succeeding in securing investments in some business enterprise from all the congregants. In some cases, the clients or customers of an organization are approached to invest in the expansion of the organization and offered to be let in "on the ground floor." Some promoters advertised in the newspaper for employees or suppliers and only much later attempted to induce them to invest in the corporation.

The utilization of social networks as a device for recruitment of victims is fairly common. Indeed, in only 39% of the offenses in the sample for which victim data are available were all victims strangers. More common are victim populations containing groups of associates or portions of various social networks. Included in the sample were cases with victim pools composed of members of particular church congregations or ethnic associations, officers at several military bases, members of particular clubs or recreational associations, members of an athletic team, publishing company editors and several university based social scientists, members of investment clubs, networks of political conservatives.

Promoters use a variety of devices to victimize social networks or relationships. Some utilize "bird dogs," a single enthusiastic investor who innocently convinces friends and associates to also invest. Some solicit investments from community or business leaders with reputations for financial wisdom or celebrities, and hope that their visibility and reputation will induce others to invest. Some contrive special systems of social referral. One

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schemes and recruiting their victims, see Shapiro, 1978b.

promoter created a phony beauty contest, one criterion of winning concerned the entrant's success in locating potential investors in a book club. Another paid kickbacks to a banker who steered clients to him. Another employed a spiritualist to advise her "clients" during a seance to buy a lot of stock from the promoters. One promoter solicited investments in hotel meetings with attendance by invitation only. Subsequent lists of invitees were generated by suggestions and nominations by attendants of previous meetings.

Of course the prior relationships so common among victims should not be attributed entirely to offender contrivance. There is a bit of greed (and perhaps larceny) in every man, and people often pass tips of hot investments to their friends. One fraud involved a social science textbook editor who tipped an investment to eminent social scientists nationwide. One case began in Canada and eventually involved entire networks of friends and family of a substantial number of the New York Jewish community. Victims in another fraud were tipped by a family member reputed to be a big trader, by a customer to a restauranteur who chased him down the street to return forgotten change, by unknown persons whose steambath conversation was overheard, and by several other persons whose conversations in a boardroom and in a car dealership were overheard.

This characterization of patterns of victimization generated by securities violations creates a rather unexpected portrait of small, localized victim populations, who are typically individual stock purchasers, who know each other and often knew the offender(s) previously, and of securities offenders as traditional scheming, manipulative con men. Clearly this portrait reflects the biased data base. It reflects the kind of offense where securing victim testimony is a crucial investigatory activity, the kind of offense with such jury appeal that it may well result in a criminal referral. Cases of this kind result in the development of victim data to support criminal action, data which

would then be available in the investigatory record. Because of biases of this kind, the characterization cannot be generalized to the pool of all securities victims. On the other hand, it cannot be dismissed as invalid - the characterization does reflect a substantial number of cases. The necessary corrective is a study of victimization that does not suffer from the investigative/prosecutorial blinders that generated this incomplete unrepresentative data base; that obtains data on victims who know little about their victimization because of their interpersonal distance from securities violators, whose plight lacks the jury appeal that characterizes the gullible marks whose story is told in investigatory records. Perhaps data can be secured on the "silent" majority who reflect the stereotypic victims of white collar crime, whatever their numbers.

Offense Magnitude

Although a consideration of victimization is important in its own right, it also serves as an indicator of the magnitude of an offense - reflected in the number of victims and their geographic and social distance. The story told through those indicators was, we recall, that many securities offenses are rather small in magnitude. Several other indicators tell much the same story. They include the economic "cost" of the offense, the number of participants in illegal activities, and the duration of these activities. These indicators are considered here.

It is very difficult, even with the finest data, to construct an indicator of the economic "cost" of illegality. If all securities offenses involved misappropriations, the job would not be too difficult. But such is not the case. How does one attach an economic price tag to technical violations involving sloppy books and records or delinquent filing or to improper sales practices - high pressure sales, poor supervison? How about where economic data

are available but not necessarily relevant, for example, the case of securities nonregistration in which $100,000 worth of securities are sold but purchasers were not defrauded and made considerable returns on their investment? How about certain kinds of self-dealing, where victimization may involve fiduciary disloyalty or lost opportunities, but no economic cost to victims? Does one estimate the profits accruing to offenders? How about the securities swindle where "victims" made money?

The unresolved perplexities inherent in these questions has meant that for some cases (42% of the sample), it was simply impossible to estimate the amount of money involved in the offense. For the remaining offenses, estimates were based on such data as loss to victims, profits to offenders, amount of money involved in illegal transactions (regardless of their consequences), and the like. The variable is of questionable reliability, but it does discriminate between $500 embezzlements and the $2,000,000 secured through a ponzi scheme or shell corporation swindle. The distribution of this variable is presented in Table 4.11. The median is $100,000. Two cases involved less than $100; two cases, more than $35,000,000. Those offenses involving the greatest amounts of

TABLE 4.11: THE AMOUNT OF MONEY INVOLVED IN THE OFFENSE

	(N)	%
$1,000 or less	(5)	2%
$1,001 - $2,500	(5)	2%
$2,501 - $5,000	(9)	3%
$5,001 - $10,000	(22)	7%
$10,001 - $25,000	(25)	8%
$25,001 - $100,000	(87)	29%
$100,001 - $500,000	(95)	31%
$500,001 - $1,000,000	(23)	8%
$1,000,001 - $2,500,000	(20)	7%
$2,500,001 +	(14)	5%
Total	(305)	
Not Appropriate	(221)	

money include stock manipulation, self-dealing, and boiler room activities. Whereas 18% of all violations involve more than $500,000, this proportion for those offenses, respectively is 41%, 36%, and 33%.

Although a median of $100,000 seems like a substantial amount of money, especially relative to street crime, it is rather insignificant, particularly when you note that during the period reflected in the research, most offerings of less than $200,000 or $300,000 were exempted from full SEC registration because of their small magnitude. Most likely this figure is biased in a downward direction because it is much easier to estimate the cost of clear-cut embezzlements than more complex schemes. Nonetheless, it is another reflection of the fact that many SEC investigations during this period pertain to offenses rather limited in scope.

Another indicator of the magnitude of illegal activities pertains to the number of participants in these activities. These data were presented earlier in the chapter in another context (describing offender characteristics). They also paint a portrait of offenses rather small in scope. We recall that the median number of participants was three and that less than 5% of the investigations pertained to five or more parties. Offenses involving boiler rooms and investment schemes tended to have more participants, those involving broker-dealer technical violations and previous social control, few participants.

A final reflection of the scope of illegality, and a phenomenon of interest in its own right, pertains to the duration of violative activities. Data are available which enumerate the number of days (or years) from the institution of illegal activities to their cessation (whether from "natural causes" or due to social control activities). These data are also somewhat misleading. They do not reflect the intensity of activities, periods of inactivity, variable amounts

in start-up time by offense, and the like. But it is unclear how more realistic estimates could be made. The distribution of this variable is presented in Table 4.12.

TABLE 4.12: THE DURATION OF ILLEGAL ACTIVITIES

	(N)	%
Less than 4 months	(76)	14%
4 - 9 months	(81)	15%
9 - 15 months	(82)	16%
15 months - 2 years	(87)	17%
2 - 4 years	(83)	16%
More than 4 years	(70)	13%
Don't Know	(47)	9%
Total	(526)	

As the table reflects, the duration of illegal activities is rather substantial. Twenty-nine percent of them have been continuing for more than two years. And 79% of all offenses were still on-going at the time that SEC investigation began. This is particularly true of the long duration cases: 89% of those of greater than 4 years duration were still continuing in contrast to 67% of those of less than 4 months duration. Cases involving only technical violations are shortest in duration (one-quarter lasted more than 2 years) and least likely to be continuing, those involving the combination of technical and registration violations as well as securities fraud are of greatest duration (almost half lasted more than 2 years), and are most likely to be continuing at the institution of investigation.

The Location of Illegality

A final characteristic of illegality to be considered pertains to the

location of illegal activities. Data were gathered on the residence of individuals and the place of business of organizations subject to investigation. By aggregating them, one can get some sense for the geographic location of securities violations. These data are presented in Table 4.13. Those states housing the largest number of offenders were New York (517), California (113), Texas (111), Washington (87), and Florida (78). The assignment of states to regions in the table seems a bit bizarre, but it attempts to reflect some of the regional differences in securities offenses and securities offenders.

As the table reflects, 30% of the offenders are located in New York and New Jersey, due primarily to the fact that half of all stock brokers investigated by the agency are in that area. Only the Southwest houses more than 10% of the brokers. The Midwestern states are quite unlikely to contribute securities offenders, not surprising, given the role of business in that area, but so are the New England and Mid-Atlantic states. The more interesting comparison pertains to the column reflecting the residence of stock issuers and their associates. A substantial number of them come from more unorthodox locations, the South (10%), Southwest (20%), and Northwest (14%). These figures reflect many of the land and mining swindles illustrated earlier in the chapter, very common in these areas.

These figures are difficult to evaluate, because they reflect such different bases in population, the extent of business, and the like. One gross control simply assumes that all individuals theoretically have equal opportunity for illegality, and contrasts the number of offenses per region to its 1975 population.[27] The ratio in the last column simply divides regional population (in 100,000's) by the number of cases in that region. Increasing ratios reflect

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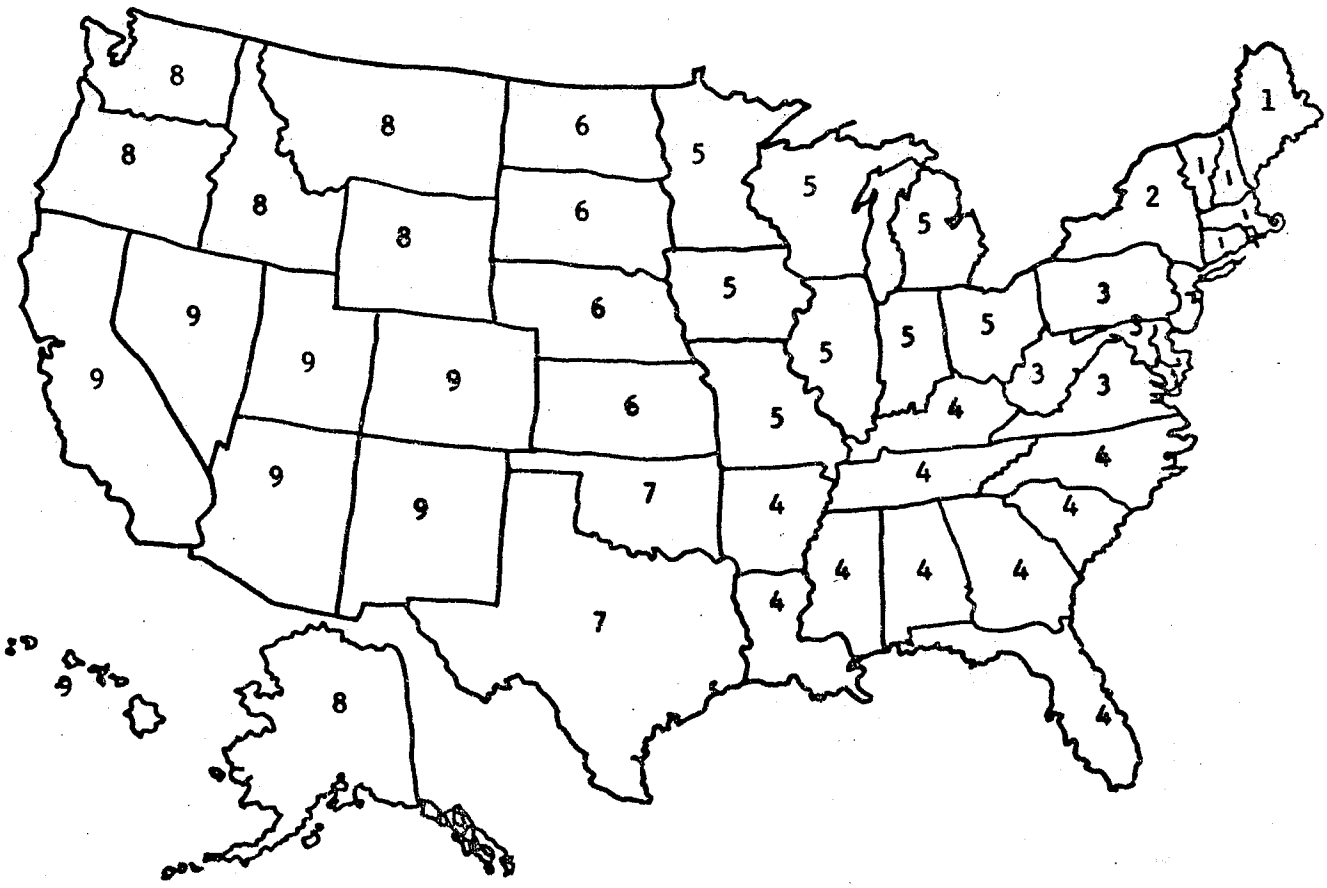
[27]This is very gross. It does not reflect business population data nor does it take population movements during the 25 years reflected in the sample into account.

TABLE 4.13: THE LOCATION OF ILLEGALITY

	Issuer	Broker	Other	Total Cases	Population Case Ratio
1. New England	(31) 3%	(32) 4%	(9) 5%	(72) 4%	1.69
2. New York, New Jersey	(105) 12%	(432) 50%	(38) 23%	(575) 30%	0.44
3. Mid-Atlantic	(51) 6%	(61) 7%	(12) 7%	(124) 6%	1.94
4. South	(91) 10%	(56) 6%	(21) 13%	(168) 9%	2.44
5. Eastern Midwest	(86) 10%	(50) 6%	(12) 7%	(148) 8%	3.55
6. Western Midwest	(26) 3%	(1) 0%	(2) 1%	(29) 2%	1.76
7. Texas, Oklahoma	(76) 8%	(43) 5%	(9) 5%	(128) 7%	1.16
8. Southwest	(185) 20%	(92) 11%	(46) 28%	(323) 17%	0.94
9. Northwest	(127) 14%	(28) 3%	(6) 4%	(161) 8%	0.50
Canada	(37) 4%	(25) 3%	(3) 2%	(65) 3%	----
Foreign	(11) 1%	(8) 1%	(2) 1%	(21) 1%	----
Don't Know	(83) 9%	(30) 4%	(7) 4%	(120) 6%	----
TOTAL CASES	(909) 47%	(858) 44%	(167) 9%	(1934)	



fewer investigations than one would expect on the basis of population figures alone. As the figures reflect, the New York area, Northwest, and Southwest seem to be contributing the greatest caseload relative to their population. Of course, this does not mean that there is more illegality in these regions, only that more investigations are opened there. This could reflect SEC regional office policy and resources as easily as it could reflect underlying patterns of offense.

Another way of locating securities offenses is over time rather than over place. There are very few differences in the patterning of offenses over time discernible from these data. In large part, this is because the small sample size precludes making fine enough time gradations to pick up the fickle trends in the securities markets and the violations they generate. Self-dealing, investment schemes, and offenses related to broker-dealer sales techniques all increase somewhat over time in the proportion of offenses. Nonetheless, the mean year of initiating investigation of all other offenses is basically the same - 1961 or 1962 (means for self-dealing, investment schemes, and sales techniques are 1962, 1965, and 1963, respectively). If there are longitudinal patterns, they are simply too fine to be discovered by devices as gross as yearly means and five year intervals to which this sample size limits analysis.

Conclusion

This chapter promised to be telescopic rather than microscopic and, notwithstanding a few convoluted tables, it has been just that. Much of the view provided by the telescope has been as expected, but there have been a few surprises. We have learned that most of the action in securities offending is found among securities issuers, broker-dealers, and associated persons; that more persons than organizations are investigative subjects, but most offenses include the co-participation of both; that investigated organizations tend to be

rather small, rather young, and if not in the finance industry, most likely engaged in mining; that the majority of individuals investigated are corporate officers or in high managerial positions; that half of all persons and a third of all organizations have been involved in previous investigations of illegality. We have learned that the most common elements of securities violations include technical and registration violations, misrepresentations, and misappropriations, and that some of the stereotyped SEC cases of stock manipulation, investment schemes, bribery and payoffs, self-dealing, insider trading, etc. are simply not very common. And finally, we have learned that the average investigation pertains to behavior that may not be all that significant in terms of size and scope - with relatively small numbers of offenders and victims and small amounts of money involved, with victims and offenders and victims themselves often acquaintances or intimates prior to the illegality.

Given the big picture that this chapter and the previous one have provided, of the investigative practice of the SEC and the characteristics of the parties and their conduct to which investigation is directed, analysis moves to the finer details. Chapter 5 considers one element of investigative practice, the detection of illegality, and Chapters 6-8, to its relationship to characteristics of illegality.

CHAPTER 5: SOURCES OF INVESTIGATION: PATHWAYS OF INTELLIGENCE

Chapter 4 contained descriptions and scenarios of the typical offenses over which the Securities and Exchange Commission has enforcement responsibility. As even those general characterizations make apparent, most securities violations contain several kinds or points of vulnerability to detection, vulnerabilities of the kind described in Chapter 1. Consider the following example.

Recall scenario "v" introduced in Chapter 4 as an example of a shell corporation swindle:

> Two promoters acquired control of two dormant Arizona shell corporations with no assets, issued stocks to themselves for no consideration, and bought up shares of its old shareholders for one cent apiece. They enlisted the aid of brokers in creating a market for, manipulating the market price of, and distributing this unregistered stock to the public. Facilitators of the scheme included promoters, broker-dealers, a transfer agent, conduits for the movement of shares, and nominees. The following month, a dinner meeting was held for brokers and investors to interest them in the issuer, describing its numerous (nonexistent) operating divisions, its assets (which were actually valued at only $500), and plans for future mergers and acquisitions. Within about ten months, more than 2,000,000 shares had been transferred from insiders to the public, netting somewhere between one and a half and seven million dollars.

The scenario presents several different kinds of vulnerabilities and points of vulnerability to detection efforts. They include the diffusion of information beyond the two initial promoters to (a) parties from whom the promoters acquired control of the shell corporations; (b) the old shareholders whose worthless stocks were bought for one cent apiece; (c) various co-conspirators including the initial brokers, the transfer agent, the conduits for the movement of shares, and the nominees; (d) prospective brokers and investors who attended the dinner meeting; (e) the actual investors who ultimately purchased the 2,000,000

shares of stock; and (f) the brokers who ultimately sold the stock to them. The scheme also generated artifacts - the trading record of the manipulated stock, and most likely generated observable behaviors as well, inherent in promoting the stock, soliciting prospective investors and brokers, and setting up the dinner meeting. The incentives for disclosure of the diffused information undoubtedly vary for the different parties privy to this information as does the point in the sequence of the offense that each separate vulnerability develops. If any one of the initial shareholders solicited to sell their worthless stock for one cent/share had made an inquiry with the SEC, the course of the offense might have looked quite different (assuming that the SEC took some action) than if the offense was detected as a result of disclosures by one of the ultimate victims of the scheme.[1]

As offenses continue over time, then; as they grow in numbers of participants (including direct offenders, licit facilitators, clientele or colluders, and victims); as transactions and activities become organized and diffuse into public settings; they become increasingly vulnerable to multiple detections and to detection by different means.

It should not be surprising, then, that SEC investigations are generated by a variety of means, that offenses are detected in diverse ways. This chapter is concerned with this detection process. It provides an ethnography of SEC intelligence activities. It differentiates the various pathways along which intelligence travels and describes the implementation of typical detection strategies. The substance of the chapter excludes two considerations. First,

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[1]Despite the multiple opportunities for detection, this investigation was generated as a spin-off of an unrelated investigation concerning mismanagement of an insurance company. The company had purchased 80,000 shares of the stock of the shell corporation on the basis of the glowing misrepresentations disseminated by the promoters, and was an unwitting victim. The SEC investigated these (mis)representations in connection with its investigation of the insurance company and uncovered the unrelated shell corporation swindle.

it concentrates on the univariate over the multivariate, on description of the detection process over analyses of the correlates of this process. Secondly, it considers only the detection methods found in SEC investigative work. It excludes analyses of possible detection strategies that are not found in SEC practice and speculations about the reasons for their absence. This latter excluded analysis (concerned with unused detection methods) is considered in Chapter 8; the former excluded analyses (concerned with the correlates of detection methods) are the topic of Chapters 6 and 7.

The argument developed in Chapter 1 would suggest that the SEC has three alternative strategies for detecting illegalities: (1) attempts to observe illegal behavior; (2) attempts to gather and evaluate artifacts; and (3) attempts to induce disclosures and to process unsolicited disclosures. An examination of the sources of SEC investigations in the research sample suggests that the majority of them (about 64%) result from unsolicited disclosures by participants in securities offenses and their audiences. These investigations are mobilized "reactively," then; SEC investigators react to information provided by parties external to the agency. Still, almost half of all SEC investigations are mobilized "proactively;" they are generated as a result of efforts initiated by agency staff.[2]

Investigations mobilized proactively generally result from attempts by SEC investigators to observe aspects of securities violations or to gather and evaluate artifacts of securities transactions. The use of participant observational strategies or the adoption of undercover roles by SEC investigators are not among the repertoire of proactive detection strategies

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[2]The sum of proportions of reactive and proactive mobilizations exceeds 100% because some investigations (12% of them) are mobilized by <u>both</u> proactive and reactive means. Slightly more than half are mobilized reactively <u>only</u>; and 36% are mobilized proactively <u>only.</u>

utilized by agency staff.[3]

In Chapter 1, a rather sharp distinction was made between observational and artifactual detection strategies. Observational strategies provide first-hand conclusive data on social behavior, it was argued, while artifactual strategies uncover only faint outlines of that behavior, portraits that must be reconstructed inferentially. Unfortunately, that distinction is a bit too dramatic for most securities violations. As it turns out, it is rare that observations of aspects of offenses of this kind are truly conclusive and unambiguous, that these data are interpretable without considerable inference.

Where the behaviors about which intelligence is gathered are enacted in a discrete temporal episode - like a gunshot, a mugging, a robbery - the difference between observing the behavior and examining its residues is substantial. In the former case, one has detected the behavior; in the latter case, detection can be only inferential. But many securities offenses are not enacted in a discrete episode, but rather take their shape through the aggregation of many dissimilar episodes. Recall from Chapter 1 one of Katz's defining elements of white collar crimes: that they are not "situationally specific" (1979b, p. 436). In other words, for many white collar as well as for many securities offenses, illegality does not inhere in any single situation or episode. These offenses amass numerous situations or behaviors whose aggregation is suggestive of illegality, but any one situation of which is not. The fact of illegality must be inferred from the pattern of situations that are generated. When any single observable behavior is not inherently indicative of a pattern of illegal behavior, the distinction between behavior and artifact blurs. Data of either kind must be utilized inferentially, as suggestive of a

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[3]Speculations about the reasons for and consequences of failure to utilize observational strategies of this kind are considered in Chapter 8.

potential illegality that warrants further investigation.

Furthermore, the distinction between and preference for first-hand observations over second-hand disclosures also tends to blur for offenses that are not situationally specific. Disclosures do carry the shadow of potential inaccuracies in intelligence reports and biases in their reporting. But disclosures often are made by actors whose knowledge of an offense is more than specific to a single situation, whose involvement in or purview over an offense is temporally extended. In short, for many disclosure sources, inferences are unnecessary or have already been made, and the intelligence they generate may be far less ambiguous and far more conclusive than that generated by observation and artifact.

The goal of proactive intelligence strategies, then, is not necessarily to accumulate observational over archival intelligence inputs. Nor should the goal of a system of intelligence be to favor any one source of information - observation, artifact, or disclosure - over another. Rather, it should be to amass the information from as many different intelligence sources as possible, to increase the system's access to information, and to accumulate conclusive and unambiguous information. And it turns out that all of these needs tend to be satisfied as the agency's access to illegal activities increases, whether directly or indirectly. For both proactive and reactive investigative sources, then, the crucial distinction from an intelligence perspective concerns this degree of access to the securities world and the activities contained therein.

For purposes of this analysis, the proactive investigative sources, those resulting from agency initiative, are dichotomized on the basis of differential access to settings of illegality. One group of detection efforts is organized around the assumption that the agency has no special access to settings of illegality. Detection is centered on the monitoring of public events and

communications, events accessible to countless others - journalists, attorneys, self-regulatory agencies, you, or me - anyone with an interest and persistence in analyzing the output of corporate life. I have labeled these strategies "surveillance." A second set of proactive detection strategies is organized to exploit the very few opportunities in which the agency is permitted "incursions" into the securities world, opportunities that expand their access to and scrutiny of the activites - both licit and illicit - that occur in that world. Such access is afforded by the SEC's regulatory relationships with many securities professionals and securities issuers as well as by incursive opportunities generated by ongoing investigations. These detection strategies which exploit the agency's greater access to certain aspects of the securities world are labeled "incursions" and reflect intelligence efforts generated by SEC inspections, regular filings and disclosures of actual or intended SEC registrants, and investigative spin-offs.

SEC investigations are generated reactively by unsolicited disclosures by participants in and audiences of illegal activity. Chapter 1 contained an elaborate statement of the vulnerabilities in deviant behavior created by the diffusion of information to the culpable participants in those activities, the purchasers of illicit services, licit collaborators, victims, and outsiders in some way proximate to these activities. Although these five role distinctions and indeed several other levels of subclassifications are meaningful in theory, in practice, they are too refined for the empirical patterns in actual disclosure sources - patterns that suggest that the disincentives to disclosure by many of the participants in illegality result in very small numbers of disclosures from this group. Given the realities of the data, disclosure sources are differentiated for purposes of this analysis into categories of "insiders," "investors," the "securities community," and a rather special

disclosure source, "other social control agencies." Subdivisions of each of these general categories are introduced and elaborated in the text. These role distinctions pertain to differences in access to deviant conduct and to information about that conduct. Thus, although the access to illegal conduct and associated information of some insiders is probably greater than that of other insiders, it still tends to be greater than that of investors or members of the securities community, and that of investors or members of the securities community tends to be greater than that of the SEC, other social control agencies, or you or me.

A Few Asides Concerning Access to Intelligence

A few reflections on the analytical role of intelligence access are in order. First, it is clear that the various audiences of securities violations have differential access to intelligence about them and that, in the aggregate, access is greatest in declining proportions for insiders, investors, members of the securities community, and the SEC and other social control agencies. But this characterization, though most likely accurate in the aggregate, is not necessarily so for any particular case.

In Chapter 1, the vulnerabilities of deviant behavior to detection were discussed, vulnerabilities that are inherent in certain kinds of transactions or relationships as well as those that can be accentuated or diminished by the contrivance of the participants. As an example of the former difference: ponzi schemes, regardless of their design, are more vulnerable than self-dealing schemes. Self-dealing schemes need not create transactions that are unexpected or expropriate commodities from others. They can continue indefintely because nothing out of the ordinary need occur. Ponzi schemes, on the other hand, necessarily collapse. At some point, the geometrically expanding pyramid runs out of victims whose monies can be used to pay off previous victims. Money is

being created out of thin air, and eventually the resources that supported the mythology evaporate. Hence, irrespective of the contrivance of insiders, ponzi schemes as a class of events are more vulnerable than self-dealing schemes. An example of the latter difference in offense vulnerabilities: among the class of self-dealing schemes, some are rendered more invulnerable by the contrivance of their executors. Offenders can limit the knowledge of these transactions among members of the organization being exploited and pay hush money if necessary; they can create nominees and launder transactions to conceal their involvement as beneficiaries. In other words, they can minimize the diffusion of information and attempt to limit, distort, or conceal observable behaviors or behavioral artifacts.

In short, differences in the nature of an offense, its scope, duration, and organization, and the attentiveness of insiders to cover-up concerns and their skill in orchestrating cover-up designs, all affect access opportunities for parties occupying particular roles. It is clear, for example, that the victims of a blatant, unsophisticated, fraudulent scheme ultimately have much greater access to information about illegality, than officers, directors, and other insiders of corporations that are the settings of subtle and carefully concealed management fraud, bribery, or self-dealing arrangements. Parties occupying similar roles in different offenses, then, may be as dissimilar in access opportunities as parties occupying different roles in the same offense.

A second reflection on the role of access concerns the notion of disclosure incentives, addressed in considerable detail in Chapter 1. A fair generalization derived from that discussion is that increasing access to information about behavior and increasing commitment to that behavior are positively correlated. Hence, it is generally in the interest of culpable insiders, more licit collaborators, and purchasers of illicit services, those

most privy to information about illegal activities, to continue those activities. Under normal circumstances, then, it would be irrational for these parties to make disclosures to outsiders that might result in the cessation of these activities and/or the vulnerability of these parties to social control sanctions. And even those proximate to but uninvolved in illegal activities with considerable intelligence by virtue of their proximity (family, friends, co-workers, neighbors) are unlikely disclosure candidates as well. Although they may have no investment in the continued success of the activities and no fear of complicity or ultimate sanctions, they have few incentives for disclosure. The fear of reprisals or that ongoing relationships with offenders will be impaired, as well as a general western "ethic" against interference, involvement, or "ratting," all suggest that disclosure will be quite unlikely.

Of course, as suggested in Chapter 1, social control systems can manipulate positive and negative sanctions to redesign the incentive systems for disclosure by insiders or outsiders. Still, the paradox remains: those with greatest access to intelligence concerning illegal activities are least likely to disclose this information. An intelligence system that relies on disclosures from those with greatest access to information will be a system with little information. As will be demonstrated shortly, this notion is strongly supported by the SEC research reported here.

One of the dangers of relying on intelligence from sources with greatest access to information, then, is that very little intelligence will be so generated. A second danger pertains to perspective. As access to illegality becomes greatest, perspective on the full population of offenses becomes most limited. Earlier in the dissertation, the metaphor of analytic telescopes and microscopes was used. As intelligence systems, then, attempt to gain greatest access to settings of illegality, as they come to rely on microscopic analysis,

they lose sight of the big picture, a picture provided by the telescope. For example, proactive efforts might emphasize incursions, attempting to exploit relationships with a finite set of agency registrants to maximize access to their activities. But where this strategy is pursued to the exclusion of surveillance, the agency loses access to the activities of countless non-registrants. And, to the extent that organizations involved in the most serious violations are those least likely to register with the SEC and thus avoid certain scrutiny by the agency, an intelligence strategy directed at maximizing access through incursions would do so at the risk of missing the most significant offenses.

The frustration of utilizing telescopic intelligence strategies is that the outlines of activities viewed are so faint and blurred that inferences about them are difficult. The danger of abandoning the telescope for the precision and detail of the microscope, however, is in the loss of perspective, of guidance concerning which locations on an endless landscape are most appropriate for closer scrutiny. As analysis in Chapters 6 and 7 will demonstrate, surveillance strategies are most likely to be inaccurate, to detect activities that turn out to be fully licit after closer investigation. But the actual offenses that surveillance methods do uncover are of much greater seriousness and significance than offenses detected by most incursive strategies. Again, balance is advised in the construction of an intelligence system, of utilizing detection strategies that facilitate greater access to behavioral information, but not at the expense of strategies that provide perspective on the social landscape on which countless behaviors are enacted.

Sources of Investigation

The last section of Chapter 2, concerned with research design, described in detail the collection and coding of data on investigative source, the way or

ways in which an alleged illegality was detected.[4] All suspicions or allegations of illegality directed to SEC enforcers prior to the initiation of investigation were recorded, and the first six of the investigative sources were coded and entered into the computerized dataset. The full code had over seventy categories. The categories and the distribution of data for the first five investigative sources (ordered chronologically) are displayed in Table 5.1. The table is based on data from the original random sample (N = 526).

As the distribution of data in Table 5.1 makes abundantly clear, the seventy odd categories are simply too refined for purposes of analysis. Table 5.2 provides a more abbreviated summary of the distribution of investigative sources. The seventy odd categories are recoded to correspond to the detection strategies described earlier in the chapter: the proactive strategies of "surveillance" and "incursions" and the reactive strategies of disclosures by "insiders," "investors," members of the "securities community," and "other social control agencies." These major categories are then subdivided into the more refined subcategories on which analysis will focus. These subcategories will be elaborated later in this chapter. A final change in Table 5.2 over Table 5.1 is that the chronological ordering of investigative sources is dropped. If a particular investigation is generated by a particular detection strategy at least once, that strategy is counted. Because some investigations are detected by more than one strategy, percentage totals exceed 100% and subcategory totals sometimes exceed category totals. The phenomenon of multiple detection is addressed at the conclusion of this chapter.

As is apparent from Table 5.2, even after collapsing substantial numbers of categories, some sources of investigation are very rare. For example, less than

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[4]The discussion in Chapter 2 also considers carefully questions of the validity and reliability of this variable and problems of missing data.

TABLE 5.1: SOURCES OF INVESTIGATION

	First Source		Second Source		Third Source		Fourth Source		Fifth Source	
Referrals from Government Agencies/Parties										
FTC	1	*								
IRS	1	*								
FBI	2	*	2	*						
Other Justice Department	4	1%	2	*	1	*	1	*		
Post Office	3	1%	1	*			1	*	1	*
Other Regulatory Agency	2	*			1	*	1	*	1	*
President/Executive			1	*						
Congressman/Legislative	1	*								
State Securities Commission	29	6%	11	2%	9	2%	1	*		
Other State or Local Regulatory Agency	11	2%	2	*	1	*	1	*		
Foreign Securities or Regulatory Agency	2	*	1	*						
Referrals from Self-Regulatory Agencies										
Stock Exchange	2	*	3	1%	2	*	1	*		
National Association of Securities Dealers	17	3%	3	1%						
Better Business Bureau	12	2%	4	1%					1	*
Other Self-Regulatory Agency	2	*								
Referrals from "Complainants"			1	*						
Victim	53	10%	30	6%	12	2%	7	1%		
Victim's Lawyer	11	2%	7	1%	2	*	1	*		
Victimized Corporation	2	*								
Prospective Buyer, Solicited Party, Inquiry	19	4%	9	2%	5	1%	1	*	1	*
Broker-Dealer	7	1%	4	1%	4	1%	2	*		
Other Securities-Related Professional	2	*								
Outside Lawyer	3	1%	1	*	1	*			1	*
Inside Lawyer	3	1%	1	*	1	*				
Inside Accountant (not related to audit)	1	*								
Corporate Director	1	*								
Employer	4	1%								
Employee	4	1%			2	*				
Corporate Insider	4	1%	1	*	1	*	1	*	1	*
Corporate Insider (party to illegality)			1	*						
Competitor	2	*			1	*				
Journalist			1	*						
SEC Staff or Ex-staff as Private Persons	1	*	1	*	1	*				
Anonymous	7	1%	2	*			1	*		
Other Informant	2	*	4	1%	1	*				
Complainant (Don't Know Identity)	1	*								
Prospective Seller	1	*								
Stockholder	1	*	1	*						
Other Complainant	2	*			3	1%				

continued

TABLE 5.1: SOURCES OF INVESTIGATION, continued

	First Source		Second Source		Third Source		Fourth Source		Fifth Source	
Market Surveillance										
SEC Surveillance	15	3%	4	1%	1	*	1	*		
Stock Exchange Surveillance	1	*	1	*						
Inspection/Audit			1	*						
SEC	36	7%	1	*						
National Association of Securities Dealers	3	1%	2	*						
Accounting Firm	3	1%	1	*						
Routine Non-Filing, Delinquent Filing	27	5%	4	1%						
Filing for Registration or Withdrawal of Registration	37	7%	2	*						
Reg A Filing, or Other Exemption	9	2%			1	*				
Reg A Followup	8	2%	1	*						
Other Routine Disclosure	5	1%	1	*						
Self-Disclosure	8	2%	2	*						
Special Program	1	*								
Press, Media, Advertising	20	4%	3	1%	5	1%	1	*	1	*
Miscellaneous										
Proxy Fights			1	*						
Bankruptcies	2	*			1	*	1	*		
Securities Violation Bulletin	2	*								
Mail Cover, Phone Records, Phone Company Referral	1	*	1	*	1	*				
Generated From Other Investigations - nonunique case	30	6%	4	1%			1	*		
Generated From Other Investigations - unique case	32	6%	6	1%	2	*	1	*		
Other	2	*								
Don't Know	64	12%	3	1%						
NO FURTHER MENTIONS	0		394	75%	467	89%	502	95%	518	98%

TABLE 5.2: SOURCES OF INVESTIGATION (abbreviated code)*

	% of cases	(N)	% of cases
SURVEILLANCE		(55)	12%
Market Surveillance	5%		
Other Surveillance	8%		
INCURSIONS		(167)	38%
Inspections	8%		
Filings	22%		
Spin-offs	9%		
INSIDERS		(39)	9%
Participating Insiders	3%		
Employers	1%		
Self-Disclosures	5%		
INVESTORS		(126)	29%
Actual Investors	24%		
Solicited Investors	7%		
SECURITIES COMMUNITY		(50)	11%
Informants	5%		
Professionals	6%		
OTHER SOCIAL CONTROL AGENCIES		(130)	30%
Federal Agencies	6%		
State Agencies	14%		
Self-Regulatory Agencies	11%		
TOTAL CASES		(440)	

*Because some cases were generated by more than one source, percentage totals exceed 100% and subcategory totals sometimes exceed category totals.

10% of all SEC investigations are generated by disclosures by offense insiders, and for actual culpable participating insiders, this percentage is only 3%. A very clear pattern emerges from these data. Among the reactive detection sources, those with greatest access to illegality (insiders, members of the securities community) are the least common investigative sources; among the proactive detection strategies, those with the greatest access to illegality (incursions) are the most common investigative sources. This pattern reflects a mixture of differentials in disclosure incentives and ease of access to information. But it has significant consequences for the characteristics of the pool of offenses that are detected. This issue is the subject of Chapters 6 and 7. The remainder of this chapter is devoted to descriptive concerns, to presenting a full characterization of the nature of detection strategies and their implementation.

Proactive Investigative Sources

Surveillance

We begin our exploration of proactive detection strategies with the SEC as outsider to the illegal activities which it seeks to detect and stranger to their varied participants and observers. Lacking any forms of access to the settings of securities violations, SEC investigators seek to observe public behaviors and monitor public artifacts in the hope that some of them will be indicative of illegal activity. They engage in surveillance. As Table 5.2 indicated, 12% of the investigations in the sample were generated as a result of surveillance efforts.

At its most basic, surveillance is attuned to public pronouncements of danger, difficulty, and deviance. Surveillance activities monitor reports in the press and other media and the activities of other social control organizations. Where they pertain to publicly held corporations or their

principals, or to professionals in the securities industry, these data are highly relevant. Direct reports of illegality - embezzlement or self-dealing, underworld connections, involvement in bribery or corruption or other white collar crimes (price-fixing, tax violations, etc.) - or reports of other problems - financial difficulties, proxy fights, shareholder suits - may be indicative of related securities offenses. However, reports of positive developments may be indicative of illegality as well. These may suggest the possibility of insider trading, disclosure problems, stock manipulation, or touting or other misrepresentational schemes.

Where surveillance uncovers successful organizations, then, the SEC must guard against insider self-dealing or the manipulation of successful façades for future illegality. Where surveillance uncovers organizational failure, the agency must guard against self-dealing as a source of failure, or the possibility that stockholders or the SEC itself were not properly apprised of the difficulties that led to failure. Where surveillance uncovers organizational conflict, the agency must determine whether the source of conflict or the management of conflict constitutes a violation of the securities laws. Where surveillance finds organizations in violation of the rules and regulations of other agencies, jurisdictions, or governments, SEC enforcers must determine whether correlative federal securities violations are involved, whether the cover-up of the illegality constitutes securities violations, and the like.

But the surveillance of public events for intelligence purposes pertains to more than making inferences about the causes or correlates of these events. For the implementation of illegality itself often requires public behavior, potentially subject to surveillance as well. This behavior is of two kinds, one characteristic of many forms of white collar crime, the other distinctive of

securities violations. First, the recruitment of "victims" and the dissemination of information that secures their participation in illegality often employs public forums. Secondly, securities transactions themselves are public, documented, advertised events, which can therefore be monitored.

Surveillance, then, pertains both to the transactional record of securities trading and to those public activities which seek to locate investors and to promote investment. Although the small scale investment scheme may successfully locate potential victims through soliciting acquaintances, "door-to-door" promotional strategies, the use of "bird-dogs," or through victim word of mouth, a large number of schemes must rely on more disembodied advertising in the solicitation of victims/investors. Such advertising is placed in daily newspapers, business periodicals, general purpose or specialized publications, radio and television. When encountered by SEC personnel, these advertisements may trigger investigation.

Irrespective of the need to employ public conveyances to recruit investors, offenders often require these media to promote these investments. Articles placed in the mass media which tout the investment, bear favorably upon or confirm oral representations about the quality of the investment, and the like, are often critical in securing the commitment of investors. It is the very public nature of these promotional devices and the assumption by the naive investor that they must therefore be reliable and trustworthy that facilitates the transaction. Were promotional statements contained in private media, their ability to secure investment would be greatly diminished because of the presumption that they were intentionally manipulated for this purpose.

The surveillance of publicly placed advertisements and promotional literature, which I have labeled "other surveillance," is one means of exploiting the necessarily public character of many securities offenses. As

suggested earlier, the other strategy involves the surveillance of public records of securities transactions, or in SEC nomenclature, "market surveillance." Because of the nature of the securities markets and of securities trading, an enormous amount of data pertaining to the details of securities transactions is recorded and disseminated. For any particular security, whether traded on a stock exchange or over the counter, information is available on its price over time, prices bid and asked, the volume of shares traded and the precise time of the trade, the identity of buyer and seller, and so on. And this information can be aggregated in various ways and trends plotted and analyzed. This intelligence resource, perhaps taken for granted by the social scientist, is an incredible transactional history freely available without need to penetrate institutions of privacy through coversion, infiltration, or subpoena.[5]

These strategies of market surveillance were implemented virtually at the inception of the SEC (SEC Annual Report 1935, pp. 14-15), though obviously with the development of computer technology, the capacity, sophistication, and speed of surveillance were radically increased. Data pertaining to securities prices, bids and offers, price movements, trading volume, block transactions, broker-dealer behavior, reports of insider transactions, financial news, and the like are monitored, and where patterns exceed or vary from some specified set of parameters, the "deviant case" is kicked out and further investigation pursued. Although often the deviation from specified parameters is subsequently explained by market factors or other non-violative contingencies, this strategy often

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[5]One of the greatest problems of studying criminal transactions, whether of the "white collar," "blue collar," or "organized/underworld" variety, is their location in private places. The public nature of and the degree of detail to the documentation of securities transactions provides a rich data resource for diverse intelligence purposes - enforcement, economic analysis, or social science.

isolates instances of stock manipulation, insider trading, and other violative activities.

The output of market surveillance has been likened by an SEC enforcement official to an electro-cardiogram, with little beeps indicating the transgressions. This output is perhaps not so clear, nor do the "beeps" always indicate transgressions and all transgressions generate "beeps." Nonetheless, market surveillance is a fascinating attempt by the agency to gather artifactual data on activities to which they have no access, to study the faint outlines of activities observable and to inferentially reconstruct their underlying texture. Market surveillance, then, is an innovative strategy of attempting to penetrate public transactional records to make inferences about potential underlying illegality.

Market surveillance is an acknowledged SEC investigative activity that has been relegated a position in the bureaucracy and a permanent staff to monitor and evaluate the securities market.[6] In recent years, the market surveillance function has become more specialized, with the delegation of responsibility for certain kinds of surveillance to stock exchanges and other self-regulatory organizations.

The monitoring of other public behavior, classified here as "other surveillance," tends to be fortuitous and haphazard. Among cases in the research sample, one was detected from advertising found in a magazine by a SEC staff member while waiting in a barber shop, another from promotional material a SEC Commissioner noticed in a drug store, another advertisement was noted by a staff member on a free church calendar. These examples, of course, highlight many of the more bizarre and irregular occasions for intelligence. Obviously, a

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[6]In recent years, about thirty employees, composed of attorneys, analysts, accountants, and clerks have been assigned to a market surveillance unit in the Enforcement Division of the Headquarters Office.

large number of agency staff regularly read the major financial publications as well as local newspapers. The agency has access to databanks which contain current financial news, proxy contests, routine disclosures, industry news, government affairs news, and the like. Regulatory agencies in other jurisdictions have developed a Securities Violation Bulletin, which is routinely circulated, and cites enforcement actions taken by various social control jurisdictions. And other formal mechanisms of disseminating information from self-regultory organizations to the SEC also exist. All of these information sources are routinely monitored by SEC investigators. In general, though, "other" surveillance activities are pursued more haphazardly than those of the "market" surveillance intelligence system.

The surveillance of public events and artifacts monitors a variety of data sources, then, including transactional records, mass media advertising and reportage, the actions of other social control agencies, corporate actions (press releases, bankruptcies), and the like. Both market and non-market surveillance activities reflect some rather creative and innovative strategies for attempting to penetrate social worlds to which the SEC has no access by scrutinizing the faint outlines of these activities. They reflect proactive intelligence possibilities often ignored in other social control contexts. Two-fifths of those investigations generated by surveillance were derived specifically by market surveillance; slightly more than three-fifths were derived from the monitoring of other public events through non-market surveillance.[7] These investigations comprise 5% and 8%, respectively, of all investigations in the sample.

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[7]The sum of these proportions exceeds one slightly, because one investigation was generated by both market and other surveillance.

Incursions into the "Securities World"

A second set of proactive detection methods attempt to exploit those circumstances in which the SEC has greater access to those settings in which the conduct of securities transactions, both licit and illicit, are enacted. Unlike the surveillance strategies, in which public events and artifacts are monitored by SEC investigators situated outside the "securities world," these "incursive" strategies rely on the creation of intelligence structures that reach inside this world. Intelligence strategies based on incursions exploit two types of access available to the SEC: (1) ongoing relationships with agency registrants and the intelligence opportunities afforded by routine filings and SEC inspections; and (2) greater access to portions of the securities world afforded by ongoing investigations of unrelated matters, which "spin-off" new investigations.

As indicated in Table 5.2, "incursions" into the securities world are a rather substantial source of investigation, and indeed the modal category, reflecting almost two-fifths of the investigations in the sample. This frequency is perhaps not surprising, given the numerous occasions in which SEC relationships are activated as a result of regulations pertaining to systematic periodic filings and inspection. Over half (57%) of all cases mobilized by this source involve the exploitation of filing requirements; 22% derive from inspections; and one-quarter are spun-off from previous investigations.[8]

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[8]Seven cases, or 4%, were generated by more than one of these sources, and hence their sum exceeds 100%. The measure of the incidence of spin-off sources of investigation, though accurate for a case-based unit of analysis, is actually conservative where "illegality" is the analytic unit. Within a particular docketed case, many separate unrelated illegal activities are often investigated and prosecuted. It is a matter of circumstance or expediency that a new case pertaining to the separate offenses spun-off is docketed, but it is by no means standard operating procedure. Thus, if one were able to count separate forms of offenses or separate offenders rather than enumerated cases, the number and proportion of offenses derived from spin-off strategies would undoubtedly increase, probably quite substantially.

Inspections and filings. The major proactive intelligence strategies that attempt to make incursions into the securities world exploit ongoing agency relationships with particular actors. Specifically, the regulatory structure vested in the SEC has required the registration of various professionals in the securities industry engaged in interstate work as well as the registration of public interstate securities issuances of a particular magnitude, as described in Chapter 3. The requirements of registration include not only substantial disclosures at the time of registration, but considerable periodic reporting of financial matters, material events (with both positive and negative consequences), reports of certified independent audits, and the like. Excluded from this category are unsolicited disclosures of illegality by offenders themselves, classified for purposes of this analysis as reactive disclosures by insiders. In the case of registered professionals, the SEC is also compelled to conduct routine on-site inspections of their place of business, books and records, personnel, etc.

Although perhaps a latent function of both filing and inspection systems is the discovery of illegality, their manifest function is the accumulation of data upon which sound investment decisions can be based. Regardless of their purpose, however, systems that increase the SEC's access to activities physically (as in inspection systems) or informationally (as in the case of routine filings) can be exploited for intelligence purposes as well. It must be stressed that, from an intelligence standpoint, what is critical about routine filing and inspection systems is that they provide greater access to illegality and therefore less ambiguous data to monitor.

Data about potential illegality that became available from filings and inspections may pertain to the particular subject making the filing or being inspected or rather to some business associate whose activities are recorded in

the information now available. The following examples illustrate these possibilities. In the process of submitting routine filings to the SEC, professional registrants or registered issuers may reveal information bearing on the illegal activities of others. New broker-dealers, in the process of listing their sources of capital and intended employees may reveal the reinvolvement of persons previously barred from the securities industry. Issuers may disclose information in their prospectuses about intended underwriters or business associates that may have violated the registration provisions of the securities laws or the provisions of an injunction barring them from such activity. More commonly, filings might inadvertently suggest potential violations by the parties themselves. Recomputation of financial data provided may indicate violations of SEC net capital requirements or perhaps undisclosed financial difficulties. Follow-ups or other scrutiny of representations about the nature of the business operations, prospects, the value of assets, the riskiness of the enterprise, etc. may similarly uncover underlying misrepresentations or fraudulent schemes. Or the nature of disclosures may suggest that other illegality is being covered-up, hence triggering a new investigation.

Perhaps more interesting are the intelligence opportunities generated by inspections. The possibilities of uncovering violations by the parties inspected are vast. Among violations reasonably easily uncovered by on-site inspections include agency technical regulations concerning record-keeping, reporting, the safekeeping and segregation of customer funds and securities, as well as violations involving supervision of employees, boiler room arrangements, churning or inappropriate pricing practices, sales of unregistered securities, embezzlement of customer funds.

But securities professionals, whether or not in violation of the securities laws, do not operate in a vacuum. They must work closely with customers (who

may be involved in stock manipulations or insider trading, for example), with stock issuers (who may be distributing unregistered stocks or employing fraudulent representations in their sale), and with other professionals who may be involved in any of these offenses and others as well. Inspections of the files, accounts, records of transactions, solicitations, or promotional literature held by securities professionals may generate information bearing on the illegal activities of these parties.

Apart from the specific facilities of disclosure and inspection that derive from the creation of formal relationships with particular actors in the securities markets, intelligence capabilities may derive from more general attributes of those relationships. Disturbances in the relationship may be indicative of underlying problems. For example, over-due reports, the lack of availability of parties for inspection, the return of undelivered mail directed to registrants, may all be indicative of the bankruptcy or business failure of these parties, of financial difficulties, of their involvement in other social control proceedings, of the need for cover-up or for other evasive activity.

Spin-offs. The spin-off is a third intelligence strategy that reflects agency efforts to detect illegality by making incursions into the securities world. In this case, however, the incursion is based not on some ongoing relationship between the SEC and parties the agency wants to scrutinize. Rather, it is based upon access to these locations derived from independent enforcement matters. The spin-off is likened to the behavior of the surgeon who, as long as he or she has cut into the body for other problems, inspects and perhaps removes the appendix or other organs. It may be that the appendix was not especially diseased, that, on the basis of other diagnostic criteria, the entire population of appendixes contain many elements much more deserving of excision. The point is, however, that diagnosis is much clearer when the

appendix is directly available for examination and the surgical procedure much more efficient and less costly when the body is already involved in surgery.[9] Of course, were all appendectomies performed only in the course of other abdominal surgery and were there no independent diagnostic efforts in our medical system, the population of the living might be considerably different than it is today. Intelligence strategies, whether pertaining to medical or social control data, based upon spin-offs from one problem to the next, indeed generate important biases in the aggregate of data derived, biases of the kind described in Chapter 1. That does not necessarily suggest that the intelligence obtained from spin-offs be ignored, however.

Surgery is a useful intelligence strategy for two reasons, then. First, because it brings the medical practitioner closer to the center of organic functioning, it permits clearer and more unambiguous diagnosis of malfunctioning. Second, given the assumption of some degree of correlation and spread between medical problems (i.e. the likelihood of other organ cancers is higher for the woman with breast cancer than the woman without this disease), the utilization of illness as an indicator of other illness may be a useful tool. By analogy, then, spin-offs in the enforcement area exploit the possibility of correlations or patterns of relationship among offenses, offenders, or victims, as well as the inside scrutiny of transactional settings afforded by ongoing investigations.

Let us explore more specifically and concretely the enforcement situations that generate intelligence of independent violative activities. First, ongoing investigations provide a wealth of general evidentiary materials and richer,

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[9]It has been argued that utilization of the surgical procedure may be a response as well to medical entrepreneurship. This is perhaps true in this setting as well as in the legal intelligence setting to which we analogize. Absent malpractice, the argument still remains valid.

detailed, private materials than are available for public surveillance. Although investigations may pertain to parties with some ongoing relationship to the SEC, they often do not. For these parties, absent their involvement in investigation, there is no opportunity comparable to disclosure or inspection for careful monitoring or scrutiny of their private behavior. However, once they are implicated in an SEC investigation, the possibility of penetrating this privacy is available in the "Formal Order of Investigation," a decree authorized by the Commission providing general subpoena powers. Formal orders can compel testimony and the provision of documents and records of any person or organization investigated for possible illegality regardless of their relationship to the SEC. Like systems of disclosure or inspections and like surgical diagnosis, then, investigations may generate richer, more specific, more accurate, as well as formerly unavailable data about potential offenders.

However, this discussion pertains to the role of investigatory materials as intelligence sources about unrelated offenses, not to the obvious fact that investigations generate intelligence about that being investigated. The relevance of this discussion derives from the assumption of the correlation of aspects of unrelated offenses. Securities transactions inhere in highly complex social worlds. Securities issuers as business organizations are complex structures embedded in social environments. The ongoing conduct of business requires the participation of employees, managers, directors, counsel, accountants and auditors, business associates, suppliers, clients, and the like. Furthermore, the transactions through which securities of these issuers are bought and sold binds the issuer with another network of persons and organizations: underwriters, brokers, public relations personnel. Investigation that is centered on any one of the parties in this complex network may generate information about unrelated behavior of other parties in this

network.

Investigations of securities professionals - perhaps about high pressure sales or churning - may uncover information about particular securities issuers for whose stock they served as underwriter or promoter and fraudulent aspects of this issuance. Or they may uncover information about previous or additional underwriters as well. Similarly, investigations of issuers - perhaps for a fraudulent stock promotion - may introduce the agency to the broker or investment advisor involved in the promotion and disclose their involvement in similar promotions, their non-registration with the SEC and the like. These examples reflect inter-organizational intelligence spin-offs. In other instances, the spin-off may be intra-organizational. The agency investigates the case of embezzlement of customer funds by a salesman employed by a particular broker-dealer firm, and thereupon learns that the firm was engaged in stock manipulation or a fraudulent stock issuance. The perspective offered by investigation may be somewhere between inter- and intra-organizational. The investigation of a particular party may reveal other business interests or roles that it holds. The investigation of technical violations of a broker-dealer, for example, may reveal that its president is also the officer of an issuer engaged in a fraudulent promotion.

The previous examples were based on the assumption either that violation is so pervasive that the informational penetration of one social location will most likely uncover violations by related parties or that "birds of a feather flock together," that it is likely that the associates of an offender are involved in illegality themselves. An entirely different assumption may also provide a fruitful resource for intelligence spin-offs. That pertains, not to the distribution of offenders, but rather to the distribution of victims - that parties, whether by virtue of gullibility or of the magnitude of their

transactions, are potentially victims of multiple, unrelated offenses. The extent of repeat victimization in the securities area is, of course, an empirical question, the answer to which should bear upon the viability and fruitfulness of this strategy. Nonetheless, some offenses in the sample were detected by virtue of repeat victimization. For example, victims of a particular fraudulent scheme were interviewed, and in the course of their testimony, they commented upon previous investments, their relationship to a particular broker, etc. which indicated that they had been victimized in these unrelated matters as well.

The investigation, because it permits scrutiny of evidentiary materials and participants at the center of illegal activity and directs attention to actors who may by personal experience or social relationship have experienced other illegal activities, is an important intelligence source, spinning-off other matters worthy of investigation.

The Proactive Strategies

These examples of surveillance, filings, inspection, and spin-off reflect the range of strategies employed by SEC staff to ferret out instances of potential illegality on their own initiative. The implementation of proactive methods provides some really creative intelligence efforts. Still, these methods have their limitations. Where all aspects of the execution of illegality can be located in private settings, where the magnitude of transactions are small and hence bypass market data reporting systems, where participants are not registered with the SEC and are unrelated to those who are associated with the agency through registration or other enforcement, it is unlikely that these offenses will be detected through proactive means. We turn now to the assorted pathways by which intelligence inputs are directed to the SEC by parties external to the agency. Specifically, we consider reactive

investigative sources generated by disclosures from "insiders," "investors," members of the "securities community," and "other social control agencies."

Reactive Investigative Sources

As reflected in Table 5.1, about forty separate categories of actors in the securities industry and their audiences make unsolicited disclosures or inquiries to the SEC on occasion, communications that ultimately generate SEC investigations. These diverse actors have been aggregated into four rather heterogeneous categories that differentiate social roles on the basis of their presumed access to information concerning illegal activities: "insiders," "investors," members of the "securities community," and "other social control agencies." As described earlier in this chapter, these presumed differences, though accurate in the aggregate, are not necessarily so at the level of the individual offense. The heterogeneity of actors within given categories may be distressing, but it is inherent in attempting to summarize a complex and distinctive social world.

For each social role category, characteristics of its constituents, the circumstances under which disclosure is made, and the substance of the communications to the SEC are described in the following sections. The nature of these allegations are summarized in Table 5.3, for the group of reactive investigatory sources as a whole, and for each of the social role categories as well. The substance of the communications is diverse, and this table simply aggregates the most common allegations: (1) requests for or transmission of information, (2) allegations of fraud or misrepresentation, (3) allegations of embezzlement or self-dealing, (4) allegations of registration violations, (5) allegations of technical violations of SEC regulations, (6) complaints about the sales techniques of brokerage firms or allegations of other problems in these firms. In the following sections of this chapter, there will be a series of

TABLE 5.3: ALLEGATIONS IN DISCLOSURES TO THE SEC

	(a) Insiders		(b) Investors		(c) Securities Community		(d) Other Social Control Agencies		TOTAL	
Requests For or Transmision of Information	(8)	27%	(37)	31%	(9)	19%	(37)	32%	(65)	26%
Fraud, Misrepresentation	(16)	53%	(67)	56%	(29)	60%	(52)	45%	(121)	48%
Embezzlement, Self-Dealing	(8)	27%	(23)	19%	(6)	12%	(8)	7%	(36)	14%
Registration Violations	(4)	13%	(20)	17%	(13)	27%	(38)	33%	(55)	22%
Technical Violations	(4)	13%	(3)	3%	(2)	4%	(9)	8%	(14)	6%
Sales Techniques, Assorted Problems	(5)	17%	(33)	28%	(9)	19%	(31)	27%	(61)	24%
Don't know, none	(9)	--	(7)	--	(2)	--	(14)	--	(24)	--
TOTAL CASES	(39)		(126)		(50)		(130)		(276)**	

*Allegations per case may exceed one; hence percentage summations may exceed 100.

**Total number of cases mobilized by these sources.

refinements of Table 5.3 - Tables 5.3a - 5.3d - which will break down the distributions of allegations for different kinds of parties within each social role category.

As reflected in Table 5.3, there are differences between social role categories in the substance of allegations made, but they are not as substantial as one might expect. Indeed, as we will discover in subsequent discussion, the differences between these social role categories are often not as substantial as differences among various kinds of parties within a particular category. This suggests that, although the major role categories may differ in access to information, they may not differ in disclosure incentives. For example, the need for information requested from the SEC may be found among different social roles: the management of a corporation contemplating action of various kinds (insiders), potential investors who contemplate making a particular investment, or social control agencies which contemplate taking enforcement action. Similarly, the SEC may be drawn into a situation by way of intelligence transmission to provide a source of sanctions or leverage to impose in a conflict situation. Insiders may try to bring in the SEC to depose others vying for control; investors may do so to obtain leverage on offenders to provide restitution; other government agencies may do so when it appears that they may otherwise lose their own enforcement proceeding. In other words, similar roles or contingencies found in different role categories may generate similar intelligence outputs.

Insiders

As described in Chapter 1, disclosures can be made by those participating in and contributing to deviant behavior. These parties are included in the category of insiders. However, the category constructed here is somewhat broader: it includes all members of organizations from which deviant

participants are drawn. In other words, the category may actually include non-participating non-culpable organizational members. This somewhat mistaken assignment is necessitated by three factors. First, as Katz (1977, 1979a) and others have suggested, it is often extremely difficult to identify culpable participants in organizations which are attentive to cover-up concerns. Secondly, non-culpable organizational insiders are nonetheless proximate to illegal activities. Their access to incriminating information is certainly quite variable, but it tends to be better than outsiders who play varying roles with respect to the illegal activities. Finally, the N's are so small (4-21 cases, depending on definitions), that, for purposes of analysis, they cannot be considered separately anyway.

One potential group member is excluded from the insider category: that of the anonymous informant, of which there were 22 in the research sample. Although some informants may be insiders, indeed, perhaps, culpable participating insiders, it is just as likely that they are not and derive their information from some other association with the offense or offenders. They were instead assigned to the "securities community" category, a rather general, amorphous, heterogeneous mixture of social roles. This reflects a conservative decision, one which seeks to weight the informant role with as few specific assumptions as possible.

Despite diversity in the range of possible "insider" statuses, insiders share one common characteristic. They are positioned at the center of illegal activity, and therefore their vision is the clearest, their ability to read detail the sharpest, and the amount of behavior and information discernible to them the greatest. From an informational perspective, then, insiders are potentially the richest source of intelligence.

Of course, this rich capacity for intelligence is undercut by the

infrequent opportunities for and disincentives to the dissemination of information to social control agencies. This is reflected in the marginal distribution of intelligence sources presented in Table 5.2, which indicates that only 9% of all cases in the sample were derived from referrals by insiders, the smallest category of all investigative sources, both reactive and proactive. Even if the contribution of informants (classified in the "securities community" category), some portion of whom might bear some insider role or relationship, were added, this category would still include only 14% of all cases in the sample. The irony, then, though not surprising, is that where the quality of intelligence is the highest, the quantity that is transmitted is the lowest. Nonetheless, the disincentives to reporting by insiders apparently do not entirely render them mute and halt their transmission of inputs, as demonstrated in the 39 cases in the sample in which insiders did make disclosures.

A closer examination of the social roles of insider investigative sources and the nature of their allegations should provide some sense for the social occasions and incentives for mobilizing the SEC. Despite the problems of discriminating and identifying social roles of insider intelligence sources, several gross discriminations, reflected in Table 5.4, can be made.

TABLE 5.4: ROLES OF "INSIDER" COMPLAINANTS

	(N)	% Total Insiders
Self-Disclosures (inside directors, accountants, attorneys)	(21)	54%
Employers	(4)	10%
Participating Insiders	(15)	38%
TOTAL INSIDERS	(39)	(9% of all cases)

The categories of "self-disclosures" (comprising 54% of all insiders) and "employers" (comprising 10% of all insiders) pertain to communications by insiders about matters for which they are in some sense "outsiders." "Self-disclosures," typically made by insider attorneys, accountants, or directors, pertain to some problem or issue salient to the organization as a whole or to its highest-level managerial personnel. Inputs transmitted by "employers" pertain rather to the activities of lower-level employees and do not reflect organization-wide issues. In both instances, however, the insider sources are non-participants or not culpable for the matters they report. The occasions for reporting may include legislation or professional ethics mandating self-disclosure of particular kinds of difficulty to the SEC, victimization of the organization by employees (for example, embezzlement) or others, or attempts to manage or forestall potential illegality. Obviously, the 25 cases included in this category grossly underrepresent the population of organizations experiencing these disclosure "opportunities." The data do not provide insights about the reasons why these 25 sources chose to report and the countless other potential sources did not.

The "participating insiders" category, the source of 38% of insider referrals, includes parties bearing some degree of culpability for or involvement in illegality. They may be major executors of illegality, present or former facilitators, employees, consultants, or factions within organizations. These intelligence sources find opportunities for complaint in retaliation, self-preservation, or the manipulation of power. They report after having resigned or being fired by a culpable organization, after unintentionally becoming implicated in illegality, in order to get the upper hand over other participants in a conflict situation or corporate power struggle, to save their skins either absolutely or relative to others in the eventuality of the

intervention of social control agencies.

A sense for the social occasions for reporting is also provided by the examination of a refinement of the distribution of allegation by reactive investigative source (Table 5.3), displayed in Table 5.3a. Some of the proportions and differences reflected in Table 5.3a are not especially surprising. For example, virtually all of the allegations by "employers" pertain to either fraud or embezzlement by organizational employees. This derives from the fact that illicit opportunities for individual employees are almost necessarily limited to these phenomena. However, there are rather significant and meaningful differences in charges emanating from the other categories. Participating insiders invoke the SEC to level basic charges of lawbreaking: fraud and misrepresentation particularly, though also embezzlement and self-dealing, registration violations, sales techniques and assorted problems. Self-disclosures pertain to a rather different agenda of matters - essentially a little bit of everything - but the lawbreaking component, particularly pertaining to non-technical regulations, is significantly lower. Contrast, for example, rates of allegation of fraud, embezzlement, or non-registration between "self-disclosures" and "participating insiders," 42% and 87%, respectively, or of rates of technical violations or the transmission or request for information, of 75% and 27%, respectively.

These differences in allegation suggest the rather different circumstances for reporting and targets of allegation at issue when referrals emanate from different insider roles. Disclosures by managerial/supervisory personnel pertain to illegalities by employees, to technical difficulties by their organization or simply request or transmit information. They are quite unlikely to allege violations that pertain to serious and fundamental lawbreaking by the organization itself. In contrast, these latter issues are precisely the

TABLE 5.3a: ALLEGATIONS IN REFERRALS BY INSIDERS

	Self-Disclosures (by Directors,) (Attorneys,) (Accountants)		Employer Role		Partici-pating Insider		Total Insiders	
Requests for or transmission of information	(5)	42%	(0)	0%	(4)	27%	(8)	27%
Fraud, Misrepresentation	(4)	33%	(2)	50%	(11)	73%	(16)	53%
Embezzlement, Self-Dealing	(2)	17%	(3)	75%	(4)	27%	(8)	27%
Registration Violations	(0)	0%	(0)	0%	(4)	27%	(4)	13%
Technical Violations	(4)	33%	(0)	0%	(0)	0%	(4)	13%
Sales Techniques Assorted Problems	(2)	17%	(0)	0%	(3)	20%	(5)	17%
Don't know, none	(9)	—	(0)	—	(0)	—	(9)	—
TOTAL CASES	(21)		(4)		(15)		(39)	

substance of allegations by participating insiders. Perhaps the costs and risks of reporting simply do not justify transmission of less pervasive problems by participating insiders or perhaps their scope of perspective does not include matters of this kind. In any event, the nature of allegations is considerably different by insider role, a fact that should not be obscured by their classification in the same category.

Investors

Parties who invested monies in a particular security, who sold these investments, who did business with a broker-dealer or investment advisor, or who were solicited to do any of the above, are one of the most common sources of intelligence about illegality. This is not surprising. On the one hand, investors are frequently the most numerous participants in illegality (thousands of parties may hold a particular security subject to abuse or may be clients of a particular brokerage firm or advisory service), and, on the other hand, they stand the most to gain from the involvement of the SEC in investigating their alleged victimization. For investors and/or victims, the SEC promises both informational resources on potential investments and enforcement resources that can be invoked to secure restitution, revenge, or to assure the success of a private civil action.

Although the incentive system and the conditions under which investors, solicited investors, or victims mobilize the SEC remains largely speculative, there are important obstacles to investor transmission of intelligence. As described more fully in Chapter 1, these obstacles pertain to impediments to knowledge of illegality, victim unwittingness, on the one hand, and absence of direct victimization, on the other. The most significant occasion for investors to refer information to the SEC is that on which they assert that they have been victimized. Where offenders contrive elaborate cover-up schemes, investors may

never learn that they have been victimized, and may therefore have no reason to contact the SEC. Secondly, as elaborated in both Chapters 1 and 4, there are offenses in which there simply are no victims or in which victimization is so diffused, that it becomes difficult to identify who or what the victims may be. Hence, it is unlikely that investors will complain to the SEC about offenses of this kind.

Despite these obstacles to referral of information about illegality to the SEC by investors and/or victims, the number of referrals is reasonably high relative to other modes of intelligence. As indicated in Table 5.2, investor disclosures generate 29% of all SEC investigations and 46% of all cases mobilized reactively. Two distinctive groups of investors emerge from this research: "actual investors," who have already committed funds to one or more investments or brokers about which they have lodged a complaint, and "solicited investors" who have been offered a particular investment opportunity but have not yet committed funds. Actual investors tend also to be victims; solicited investors tend not to be victims. Seventy-seven percent of all cases in the investor category were generated by actual investors, 18% by solicited investors, and 5% by both actual and solicited investors.

Most securities violations involve more than one investor. Therefore, for some offenses, more than one investor communication is received by the SEC. For 63% of the investigations generated by investor referrals, more than one such referral was received by the SEC prior to their institution of investigation. Overall, the mean was 3.7 investor complaints per case. However, the mean varies by type of complainant. For cases where only actual investors complain, the mean is 3.21 complaints/case; for those where solicited investors complain, the mean is 4.96; and where both actual and solicited investors complain, the mean is 6.83. The number of separate disclosures per case is greatest, then,

where solicited investors request information than where actual investors report their victimization.

Investor referrals are typically expressed in individual letters sent to the SEC, though infrequently, complaints or inquiries are presented in person at SEC offices. Occasionally complaints reflect the sentiments of a group of investors who have banded together, but the individual component of referral is almost universal. More frequently (14% of all investor referrals) referrals are made by the attorneys of investors. The substance of these communications are by no means direct allegations of illegality. Communications may concern inquiries about a security (often that it seems too good to be true) by solicited investors or inquiries about securities issuers or professionals by already committed investors. Investors may only suspect illegality, may express victimization where none, in fact, exists, or may simply be disgruntled by the conduct of parties with whom they have transacted.

Table 5.3b presents the distribution of matters alleged by actual and solicited investors in referrals to the SEC. Allegations by actual investors more closely resemble those of other reactive investigative sources than do allegations by solicited investors. Actual investors most likely allege fraud, embezzlement, assorted problems pertaining to professionals, mismanagement, etc. This perspective derives from the involvement of actual investors in transactions that are apparently troublesome, and their allegations pertain to some aspect of these transactions. The perspective of solicited investors is necessarily different, in that they presumably have not yet transacted, and are thus not yet economically victimized. It is predictable, then, that solicited investors are a major source of informational requests made to the SEC, and that the proportion of their referrals to the Commission of this type (67%) is more than twice that of any other reactive intelligence source. It is also

TABLE 5.3b: ALLEGATIONS IN REFERRALS BY INVESTORS AND POTENTIAL INVESTORS

	Investors		Solicited Investers		Total Investors	
Requests for or Transmission of information	(24)	24%	(20)	67%	(37)	31%
Fraud, Misrepresentation	(60)	61%	(15)	50%	(67)	56%
Embezzlement, Self-Dealing	(23)	23%	(3)	10%	(23)	19%
Registration Violations	(17)	17%	(9)	30%	(20)	17%
Technical Violations	(3)	3%	(0)	0%	(3)	3%
Sales Techniques, Assorted Problems	(32)	32%	(4)	13%	(33)	28%
Don't Know, none	(6)	--	(2)	--	(7)	--
TOTAL CASES	(105)		(32)		(126)	

predictable that solicited investors have a rather high proportion of allegations of registration violations (30%), since discerning the fact of registration is a relevant concern in making an investment decision. The low proportion of referrals alleging technical violations, improper sales techniques, embezzlement, and the like by solicited investors, reflects the fact that these problems often pertain to securities professionals, yet solicitation often is made by issuers. Furthermore, with the exception of boiler room sales techniques, they are problems not likely to become apparent to an investor until after a transaction is consummated. Hence, investors and solicited investors differ substantially in the kind of transactions or contemplated transactions salient to them, in the amount of information about an illegality they possess, in the experience of victimization, and in the reasons for initiating communication with the SEC, reflected in the substance of this communication. Hence, the nature of illegality as well as its duration and impact may vary considerably within the category of offenses referred by investor complaints.

The Surrounding "Securities Community"

A number of observers, both organizational and individual, surround illegal activities. They are neither direct participants in these activities nor official observers like the SEC and other social control agencies. Rather, by virtue of their business relationships, their placement in business networks, and their physical location proximate to that of offenders, they are permitted varied opportunities for scrutiny of and intelligence about illegal activities. Members of this surrounding community often have some access to the settings of illegality, and in some circumstances, their access may be substantial and significantly greater than that of investors.

This category includes both securities professionals and other surrounding business organizations. Anonymous complainants and informants were assigned to

this category as well. As noted earlier, this assignment may be inappropriate. Informants may, in fact, be either investors or insiders in illegality. Unfortunately, their anonymity precludes any certainty of correct assignment, and so they are assigned to the most amorphous category. The assignment is worthy of note, however, particularly because informants constitute a rather significant proportion (44%) of the overall category of members of the securities community. Given the suspicion that some informants and anonymous complainants are actually participants in rather than observers of illegality, it is appropriate to think of this intelligence source as transitional between inside and outside, between the surrounding community and the actual participants, located somewhere along the boundaries of illegality.

Table 5.5 presents the distribution of the various investigative sources in the surrounding community. In all, these sources account for 11% of all cases in the sample; non-informants account for only 6% of these cases. The most

TABLE 5.5: REFERRALS FROM THE SECURITIES COMMUNITY

	(N)	%
Broker-Dealer, Investment Advisor	(14)	28%
Other Securities Professional (outside attorney, accountant, banker)	(8)	16%
Non-Professionals (competitors, journalists, telephone company)	(7)	14%
Informants	(22)	44%
TOTAL SECURITIES COMMUNITY	(50)	(11% of all cases)

common source is the informant, as noted earlier, with broker-dealers and investment advisors representing 28% of these sources, other professionals (outside attorneys, accountants, bankers, etc.) 16%, and miscellaneous non-professional organizations (competitors, journalists, etc.), 14%.

Professionals. The most important source of referral among members of the securities community is that of the broker-dealer or investment advisor. By definition, a broker is a middleman; he or she necessarily intervenes in the transactions of buyers and sellers, whether they be investors or stock issuers. He or she is the vortex of independent information systems, and must sort out and manage conflicting data. In addition to transactional intervention, the stock broker also plays an intelligence role. With some degree of variability, he or she is expected to "know" the market, to have accumulated and evaluated "hot tips," to be aware of potential opportunities as well as potential disasters. By virtue of this role of middleman and "spy" (of some degree of competence), the stock broker is a unique intelligence broker as well.

Referrals from broker-dealers occur through verbal or written communication to SEC offices, occasionally through "idle chatter" and interaction in the course of an SEC inspection of their premises. The conditions that give rise to information they subsequently refer are varied. The broker may obtain information of questionable validity from stock issuer representatives who routinely must solicit brokers in the marketing of their securities. Broker insights may derive instead from the behavior or requests of their clientele - to buy large quantities of relatively unknown securities or for which the broker could not find a market - or from the solicitation of their clientele by another broker-dealer to buy particular securities at an unusually low price.

Other members of the business community transmit intelligence as well. Accountants and attorneys are often recipients of information by virtue of the

services they perform as well as by virtue of their potential susceptability as investors themselves.[10] Bankers have some scrutiny over transactional markets as well, by virtue of the role of securities as collateral for loans and the deposit or withdrawal of substantial sums from investor bank accounts in connection with securities investments.

Trade associations or competitors of stock issuers sometimes scrutinize the behavior of issuers and may have particularly strong incentives to report the misbehavior that they uncover. A very different intelligence perspective is illustrated by disclosures from the telephone company, which did refer several cases in the research sample. The telephone company submitted information concerning extensive orders for new telephone lines by particular broker-dealers or substantial monthly increases in long-distance charges for particular broker-dealer accounts. Both of these phenomena are most likely indicative of the institution of a boiler room operation. As potential facilitators of illegality through the provision of services necessary for its execution, the phone company has a unique intelligence perspective.

Although each of these roles in the securities community - brokers, investment advisors, attorneys, accountants, bankers, business associates, competitors, the telephone company, etc. - are quite different, for purposes of analysis in the remainder of the dissertation, they have been aggregated into a sub-category: "professionals." This was necessary because of the small number of investigative sources of this kind. Even fully aggregated, the N for "professionals" is only 28, 6% of all investigations in the sample.

Informants. Relatively little can be said about informants and anonymous

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[10]This category pertains to the activities of attorneys (and accountants) independent of any involvement with any of the participants in illegality. Where attorneys assist in investor complaints to the SEC, they are classified in the "investor" category.

complainants as intelligence sources. By definition, few data are available about their identities or the circumstances under which they transmit information. The nature of the matters alleged in these referrals are addressed in the following section.

Table 5.3c presents the distribution of matters alleged in referrals from the surrounding community. Like reactive inputs emanating from other sources, these allegations are most likely to pertain to fraud or misrepresentation. The proportion of all allegations of this kind is slightly higher for this source than for the others - 60% in contrast to other proportions ranging from 45% to 56%. Proportions of other kinds of allegations are not particularly distinctive for this intelligence source, save the rather low proportion of requests for or transmission of information (19% relative to a range of 27% to 32% for other sources). This latter finding is not surprising; given the lack of direct involvement of members of the surrounding community in illegality or its enforcement, information has little relevance.

In addition to these general trends for the category as a whole, Table 5.3c indicates some important differences in the nature of matters alleged by various subgroups of the securities community. Informants are a good deal more likely to allege fraud and registration violations than other members of the securities community and a good deal less likely to request information. Broker-dealers and investment advisors are more likely to allege embezzlement and self-dealing. These differences undoubtedly reflect the quality and nature of information accessible to various positions in the securities community.

Members of the business community, then, are often "brokers" of information, equipment, customers, clientele, etc., and by virtue of this structural position, are privy to substantial intelligence. Yet despite their opportunity for intelligence, members of the surrounding community are terribly

TABLE 5.3c: ALLEGATIONS IN REFERRALS FROM THE SECURITIES COMMUNITY

	Broker-Dealers, Investment Advisors		Other Securities Community		Informants		Total Securities Community	
	(N)	%	(N)	%	(N)	%	(N)	%
Requests for or Transmission of information	(4)	29%	(4)	31%	(1)	5%	(9)	19%
Fraud, Misrepresentation	(7)	50%	(8)	62%	(15)	71%	(29)	60%
Embezzlement, Self-Dealing	(3)	21%	(1)	8%	(2)	10%	(6)	12%
Registration Violations	(2)	14%	(5)	38%	(7)	33%	(13)	27%
Technical Violations	(0)	0%	(0)	0%	(2)	10%	(2)	4%
Sales Techniques, Assorted Problems	(3)	21%	(3)	23%	(3)	14%	(9)	19%
Don't Know, none	(0)	--	(1)	--	(1)	--	(2)	--
TOTAL CASES	(14)		(14)		(22)		(50)	

infrequent sources of SEC investigation. Perhaps the proportion is small because community members constitute the only category of reactive sources without some direct involvement either in illegality (as participant or victim) or in enforcement, and therefore has less to gain by involvement in investigation. So the force of apathy or the ethic of non-involvement, "non-ratting" prevails. Yet because of their independence from the offenders whose behavior they observe, members of the securities community lack the disincentives for reporting characteristic of more culpable insiders contributing to this behavior, and therefore could be a most significant intelligence resource. Absent the example of the aggrieved competitor, however, there appear to be few incentives for members of the securities community to communicate with the SEC.

One relatively limited kind of disclosure incentive pertains to sanctions available for insider trading. Typically, insider trading proscriptions apply to trading on the basis of inside information about corporate prospects - future contracts, a failing business endeavor, a new discovery or invention, etc. However, inside information about illegality may be material as well. Recently, Raymond Dirks, an investment advisor, was censured and suspended by the SEC for insider trading violations in connection with the Equity Funding scandal. Having obtained a tip about the massive undisclosed fraud surrounding the Equity Funding Corporation, Dirks advised several of his institutional clients to dispose of their holdings in Equity Funding, without first disclosing knowledge of the fraud either to stock purchasers or to the SEC (Dirks and Gross 1974, Lynch 1978).

Fear of sanctions of this kind may provide incentives for prior reporting to the SEC by members of the community who are bound to transact in matters about which they have information about illegality. These incentives have a

rather limited range, however, clearly missing telephone companies, banks, landlords, brokers or advisors, and others who decide not to transact. Perhaps the absence of either positive or negative incentives for reporting accounts for the rather small proportion of intelligence inputs from this source, despite the potential richness of its position in the securities world and of the data which its members regularly scrutinize.

Other Social Control Agencies

A significant number of intelligence inputs (30% of the sample) are directed to the SEC from other social control agencies, among them, federal regulatory agencies, divisions of the Justice Department, state securities commissions and other state regulatory agencies, private social control or self-regulatory agencies (stock exchanges, Better Business Bureau, the National Association of Securities Dealers), and Foreign and other miscellaneous agencies.

The most common sources of referral from other social control agencies and their relative proportions in the sample are indicated in Table 5.6. As in the other tables in this chapter, the sum of percentages may exceed 100 because more than one agency may generate a particular case. For the same reason, the sum of the proportions of the components of a more general category may exceed the proportion of the general category as a whole.[11] As Table 5.6 indicates, the most common source of referral emanates from state agencies (45%), particularly state securities commissions, which account for over a third of all referrals by other social control agencies. Another significant source of referral is comprised of self-regulatory agencies, contributing two-fifths of these cases.

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[11]For example, in the "Federal" category in Table 5.6, one case involved both federal justice and other federal agencies. Hence, the sum of these categories (26) exceed by one the N of the component category (25).

TABLE 5.6: REFERRALS FROM OTHER SOCIAL CONTROL AGENCIES

	(N)	% Total Social Control Agency Referrals
FEDERAL	(25)	19%
Justice	(12)	9%
Other Agencies	(14)	11%
STATE	(59)	45%
Securities Commissions	(45)	35%
Other Agencies	(16)	12%
SELF-REGULATORY	(52)	40%
Stock Exchanges	(8)	6%
National Association of Securities Dealers	(25)	19%
Better Business Bureaus	(17)	13%
OTHER	(5)	4%
TOTAL OTHER SOCIAL CONTROL AGENCIES	(130)	(30% of all cases)

Table 5.6 presents two surprises: the low proportion of referrals from other federal agencies, whether in or outside of the Justice Department, and the high proportion of referrals from Better Business Bureaus, exceeding all categories except state securities commissions and the National Association of Securities Dealers. The former finding is particularly startling in that it includes referrals from the FBI, the Post Office (for which mail fraud cases often have securities implications), requests from U.S. Attorneys or the IRS to investigate the securities implications of other investigations, and Congressional referrals of problems of their constituents, not to mention the many disparate federal agencies, all potentially vast intelligence sources, yet their rate of referral remains so small.

The transmission of inputs from other social control agencies takes a variety of forms. In some instances, social control agencies request information or investigatory assistance from the SEC. In those cases, particularistic information about alleged illegal activity is transmitted by telephone or letter. More commonly, these agencies simply pass along information - about alleged illegality or about their own social control efforts. These transmissions may be particularistic, drawing attention to a specific matter, or more universalistic, where a series of matters are routinely referred or listed in a newspaper format. The modes of transmission in these instances include communication via telephone, letter or newsletter. Referrals sometimes occur during cooperative multi-jurisdictional securities enforcement conferences in various regions, or when SEC officials are invited to visit another agency (particularly some Better Business Bureaus) and "raid" their files for enforcement matters. Most commonly, inputs are received by SEC staff via written communications. Other social control agencies are highly variable, by type as well as by region or jurisdiction, in the number and nature of intelligence inputs transmitted to the SEC and in the mode of transmission employed.[12]

These agencies secure intelligence information in much the same way as the SEC itself - through proactive efforts involving surveillance, inspections, or filings, through spin-offs from other enforcement matters, and through reaction to disclosures of other social control agencies and other participants in or observers of securities transactions. Our perspective, of course, is limited to those disclosures subsequently passed along to the SEC and not the total pool of

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[12]For example, only 2% of all cases derived from referrals by state securities commissions were directed to the New York Regional Office, which comprises 31% of the cases in the sample; 61% of the referrals from Better Business Bureaus were directed to the Seattle Regional Office which comprises only 12% of the cases in the sample.

disclosures collected by these agencies. This is undoubtedly a rather biased sample, since one might expect that referrals serve some strategic purpose for these agencies, a matter to be considered shortly. Furthermore, this discussion is limited to those cases transmitted by social control agencies for which data are available on the original intelligence sources of these matters, only about two-thirds of these cases.

The most common reason for the transmission of inputs from social control agencies to the SEC is to pass along complaint letters from victims or other participants in the securities markets that these agencies have received; almost half of the referrals for which data are available reflect this purpose. Less frequently, agencies pass along specific pieces of information obtained from their "constituencies" from means other than complaint letters: about a tenth of all referrals pertain to information obtained from the "securities community," about one-twentieth pertain to information obtained from insiders in violative behavior; and one-twentieth as well from referrals from other social control agencies.

A larger proportion of referrals (about a third) pertain to on-going enforcement activities of these agencies, and the occasion for referral bears some relationship to enforcement needs - to secure information or assistance, to report on sanctions imposed, or to pass along offenses "spun-off" from these agency investigations. For this pool of cases, it is unclear how they initially entered the intelligence stream of the agencies. Hence, about a third of those referrals, for which data are available, involve direct enforcement activities of these social control agencies; about two-thirds are occasions to convey their reactive inputs, presumably to empty their dockets and to delegate social control initiative elsewhere.

These observations pertain to aggregate figures cumulating the behaviors of

a disparate set of social control agencies enumerated in Table 5.6. Differences in this referral process can be contrasted for the major sources of referrals - state agencies, private self-regulatory agencies, and federal agencies. The differences are rather clear: state agencies differ from the others, which, though reflecting vastly disparate jurisdictions and enforcement agendas, are remarkably similar. Less than a third of the referrals from state agencies involved the transmission of complaint letters. This contrasts with figures ranging from about half for federal agencies (both justice and regulatory) to almost two-thirds for private agencies. On the other hand, about a quarter of these latter agencies (federal, justice, private) refer cases in connection with their own enforcement activity in contrast to 44% of state referrals.

It appears, then, that non-state agencies transmit intelligence to the SEC in order to dispose of potential enforcement problems, to clear their dockets; state agencies do so in order to involve the SEC in ongoing enforcement activity. This is not really surprising. State agencies share with the SEC a common enforcement agenda, their differences are more jurisdictional than substantive. Federal agencies, in contrast, share jurisdiction rather than a substantive enforcement agenda. Private agencies often lack any meaningful enforcement resources. Federal and private agencies, then, generally lacking an enforcement machinery to react to potential securities violations, pass along unprocessed intelligence inputs. For states, where this machinery is usually available, inputs transmitted are more likely to have encountered some prior enforcement attention.

These observations perhaps make too much of incomplete and rather superficial data. A proper test of the hypothesis suggested above would locate research within the referring agencies themselves and examine the characteristics of agency caseload and the reasons for the transmission of

intelligence inputs to the SEC or elsewhere. Given the importance of other agency referral, on the one hand, and the extreme and surprising variability in rates of referral by agency, on the other hand, these are by no means idle questions.

An examination of the allegations made in referrals from other social control agencies provides a more systematic sense for the nature of the referral process and for these differences by type of agency. Data on the nature of the allegations by other social control agencies were available for 89% of these cases. The data are displayed in Table 5.3d.

The rather substantial similarities and differences reflected in Table 5.3d provide a sense for the orientation and intelligence capacity of the various agencies. State agencies, with high proportions of its referrals alleging registration violations and low proportions alleging improper sales techniques, and the like, are quite unlike the other agencies. In contrast, self-regulatory agencies are much less likely than the other agencies to allege fraud or registration violations and much more likely to complain of technical violations and improper sales techniques. Federal agency allegation patterns tend to mediate between state and self-regulatory agencies. Federal agencies are especially likely to allege fraud and misrepresentation and less likely than the others to allege embezzlement or self-dealing or request or refer information.

These differences reflect the fact that state agencies have direct concern for securities frauds, many of which are concealed from SEC surveillance by intentional violation of federal registration requirements. In contrast, the self-regulatory agencies have jurisdiction over securities professionals and continuing access to information about their sales practices, technical violations, and other business difficulties. States, then, tend to have intelligence jurisdiction over unregistered (federally) entities;

TABLE 5.3d: ALLEGATIONS IN REFERRALS FROM OTHER SOCIAL CONTROL AGENCIES

	Federal Agencies		State Agencies		Self-Regulatory Agencies		Total Other Social Control Agencies	
	(N)	%	(N)	%	(N)	%	(N)	%
Requests for or Transmission of information	(6)	27%	(21)	39%	(15)	35%	(37)	32%
Fraud, Misrepresentation	(14)	64%	(30)	56%	(12)	28%	(52)	45%
Embezzlement, Self-Dealing	(1)	5%	(4)	7%	(4)	9%	(8)	7%
Registration Violations	(6)	27%	(26)	48%	(8)	19%	(38)	33%
Technical Violations	(0)	0%	(0)	0%	(6)	14%	(9)	8%
Sales Techniques, Assorted Problems	(8)	36%	(6)	11%	(19)	44%	(31)	27%
Don't Know, none	(3)	--	(5)	--	(4)	--	(14)	--
TOTAL CASES	(25)		(59)		(47)		(130)	

self-regulatory agencies over registered entities. The former transmit inputs on violations "appropriate" to the unregistered, the latter on those "appropriate" to the registered. And the jurisdiction of federal agencies is indifferent to registration status. Their primary concern is over fraudulent activities conducted in a securities context and are most likely to communicate about cases of this kind. These are, of course, gross generalizations, but suggest the diversity in the content of intelligence referred by the various "other social control agencies."

Multiple Sources of Investigation

The Incidence of Multiple Sources of Investigation

The previous discussion was designed to introduce the various sources of investigation and to provide some sense for their typicality across the sample of cases. This characterization was based on a count of the number of cases in which receipt of a particular source was reflected in the institution of investigation. Were all investigations undertaken after the receipt of one and only one intelligence input, this analytic strategy would be unambiguous. However, investigations sometimes reflect more than one input, often from more than one source. For example, a case of stock manipulation may be detected by market surveillance as well as by tips from several informants.

Reliance on the assumption that investigations result from one and only one intelligence input precludes consideration of important theoretical and policy matters. It makes a great deal of difference for the organization and output of a system of intelligence if a potential illegality generates a single or multiplicity of intelligence inputs. And, in the case of the multiple inputs, it matters considerably whether they are derived from a single or different detection methods. Very simply put, it is probable that those offenses which generate a greater number and greater diversity of intelligence inputs are more

vulnerable to social control than those which do not. Where data are available about the intelligence generating capacity of particular kinds of offenses, a social control agency can shape the composition of the investigations it pursues by directing proactive intelligence strategies to those offenses which are low intelligence generators. Even where a social control agency is totally reactive and the behavior of its constituencies defines its enforcement agenda, insight about intelligence generation is central to an understanding of the biases, emphases, and limitations in that enforcement agenda.

Table 5.7 displays the patterning of multiple intelligence inputs and multiple sources of investigation. It crosstabulates the actual number of inputs of any kind with the number of inputs deriving from different detection methods. As the uppermost cell in the left corner of the table reflects, almost three-quarters of all investigations in the sample (for which data were available on investigative source) were docketed after the receipt of one and only one intelligence input. As reflected in the row totals, 15% of all cases received two inputs, 8% three inputs, 3% four inputs, and 2% five or more inputs. It is relatively rare, then, for an investigation to involve the receipt of more than two or three intelligence inputs. Of those cases reflecting more than a single input, 22% simply involve the receipt of more than one input from the same source - for example, two or three referrals from investors. The remainder of the cases involve the receipt of inputs from two or more different detection methods - for example, referrals from one or more investors and from one or more social control agencies.[13] However, as the column totals indicate, the multiplicity of different detection methods is also relatively infrequent. Fifteen percent of all investigations were generated by

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[13]These figures are based on the six category source classification - surveillance, incursions, insiders, investors, securities community, other social control agencies.

TABLE 5.7: INVESTIGATIVE INPUTS AND INVESTIGATIVE SOURCES
(Percentages of Grand Total)

Number of Total Inputs	Number of Unique Sources*					TOTAL
	1	2	3	4	5	
1	319 72%					319 72%
2	20 5%	46 10%				66 15%
3	4 1%	18 4%	12 3%			34 8%
4	3 1%	1 0%	9 2%			13 3%
5		1 0%	1 0%	3 1%		5 1%
6			2 0%		1 0%	3 1%
TOTAL	346 79%	66 15%	24 5%	3 1%	1 0%	440

*Unique sources reflect the six categories of surveillance, incursions, insiders, investors, securities community, other social control agencies.

intelligence from two different detection methods, 5% from three methods, and only 1% from four or more methods.

Patterns of Multiple Investigative Sources

Table 5.8 presents data on the kind and number of intelligence inputs associated with each detection strategy. It differentiates those cases instituted on the basis of a single input from that investigative source only, of more than one input but only from that source, of a single input from that source in combination with one or more inputs from other investigative sources, and of more than one input from the particular source in combination with one or more inputs from other sources. The last column of the table presents the mean number of inputs for cases detected by each strategy. A great deal of information is contained in the table. One can contrast strategies with regard to the likelihood that they occur alone, that they generate more than one input, that they occur in combination with other detection strategies. As reflected in the table, there is some variation on each of these dimensions.

The major differences among the general investigative source categories pertain to incursions, on the one hand, which are quite unlikely to have multiple sources of any kind, and referrals from investors and from securities community, on the other hand, for which multiple sources are more common. While more than three-quarters of the cases involving incursions were instituted on the basis of a single incursion, this is the case for less than a third of those involving the securities community and 44% of those involving investors. Another indicator of differences in the likelihood of multiple sources is reflected in the mean number of inputs: 1.38 for incursions, 2.46 and 2.10 for the securities community and investors, respectively. Investor cases tend to have multiple inputs because of multiple complaints deriving from this source alone. Twenty-five percent of these cases involve multiple inputs from

TABLE 5.8: MULTIPLICITY OF INVESTIGATIVE SOURCES

% ACROSS	Only 1 Input		Only This Source Multiple Inputs		More Than 1 Source-Only 1 Input From This Source		More Than 1 Source-Multiple Inputs From This Source		TOTAL CASES	Mean # Of Inputs
(1) Surveillance	28	51%	2	4%	22	40%	3	5%	55	2.07
(2) Incursions	128	77%	3	2%	32	19%	4	2%	167	1.38
(3) Insiders	21	54%	1	3%	15	38%	2	5%	39	1.85
(4) Investors	55	44%	15	12%	40	32%	16	13%	126	2.10
(5) Securities Community	16	32%	0	0%	29	58%	5	10%	50	2.46
(6) Other Social Control Agencies	71	55%	6	5%	41	32%	12	9%	130	1.89
TOTAL	319	72%	27	6%	78	18%	16	4%	440	1.47

different investors. Multiplicity of investigative sources in the case of securities community referrals derive primarily from the presence of inputs from other detection methods. Sixty-eight percent of these cases were instituted as a result of inputs from other detection methods as well as from referrals from the securities community.

These patterns reflect the nature of detection itself. If one were asked to blindly predict the detection strategies generating the greatest number of inputs, most likely investors would be ranked first followed by securities professionals, insiders or other social control agencies, surveillance, and finally incursions, a ranking not unlike that actually found in the data. These predictions are based on the magnitude of the constituency of a particular detection method, reflecting the fact that, for a given offense, the number of investors is usually greater than the number of outside securities professionals, which exceeds the number of insiders, the number of independent surveillance opportunities, the number of inspections of or filings generated by a single organization, and the like. There are simply more investors involved in an offense, then, and the opportunity for multiple complaints from them is enhanced. Of course, there are many factors which facilitate or inhibit detection which may differentially affect various detection methods. So the number of inputs generated by a detection method may not be some uniform fraction of the size of its constituency or the number of detection opportunities. But, in general, the patterning of multiple inputs does correspond to common sense expectations.

The patterns observed in Table 5.8 concerning multiple inputs generated by <u>different</u> detection methods - exemplified by incursions on the low end and referrals from securities professionals on the high end - also correspond to common sense expectation. Specifically, they reflect the underlying

relationship of offense type and detection method. Offenses differ in the number of parties involved and the salience of illegal activities to outside audiences. Technical violations, for example, may be victimless, may involve few "offenders" or facilitators within a single organization, the conduct of whom is irrelevant to other social control agencies concerned primarily with fraudulent activities. It is not surprising, then, that incursions, which uncover primarily technical violations, rarely share detection responsibility with other methods. Information concerning illegal activity rarely diffuses beyond a few executors, and even if it does, it has little relevance to outsiders. A widespread securities fraud, on the other hand, may touch a diverse number of parties. Attempts to widely disseminate information concerning investment opportunities may touch many potential investors and professionals and be vulnerable as well to surveillance efforts by the SEC or other agencies. Offenses that touch many parties in different roles are therefore vulnerable to detection by each of these parties. Securities professionals, that detection category with the largest proportion of associated detection strategies, represent that group perhaps farthest removed from illegal activity. For information to touch professionals, it must also touch many more proximate roles in the social world of the activity. Referrals from security professionals are most likely to be joined by other detection strategies in uncovering a particular offense, not because of some act or practice of this group, but because they are most likely to learn of those offenses for which information has diffused to lots of other parties and roles in the securities community.

In summary, the likelihood of multiple inputs from a <u>single</u> source reflects the size of its constituency or the number of detection opportunities; the likelihood of multiple inputs from <u>different</u> sources reflects the size of the

social network generated by an offense, the diffusion of information, participation or attempts to solicit participation from various social roles and locations.

Conclusion

The offenses subject to SEC enforcement jurisdiction are terribly disparate in the kinds of substantive violations they contain, but even more significantly, in the way in which activities are organized, in the groups of participants and victims involved and their interrelations, in the social locations in which offenses are enacted, in the visibility of activities to the surrounding community, and in the subtlety and complexity of their orchestration. It is no wonder, then, that securities violations are often vulnerable to several different kinds of detection methods, at different points in their life histories, and that particular intelligence strategies are better suited to detecting one vulnerability, and therefore one kind of offense, than another.

This chapter has described the way in which the Securities and Exchange Commission orchestrates its enormous intelligence responsibilities - the kinds of intelligence activities it pursues on its own initiative as well as the nature of its response to communications from its external environment - and some of the routine and extremely creative stategies employed in attempts to detect illegality. Intelligence strategies were differentiated (1) on the basis of whether initiative originated inside (proactive) or outside (reactive) the SEC; (2) on the basis of the presumed amount of access to information on illegality available to investigative sources - surveillance and incursions for proactive sources, disclosures from other social control agencies, members of the securities community, investors, and insiders for reactive sources; and finally (3) on the basis of distinctive roles or strategies within given access

positions - market vs. other surveillance; incursions based on inspections, filings, or spin-offs; insider referrals based on self-disclosures or disclosures from participating insiders or employers; referrals from actual vs. solicited investors; disclosures from informants vs. professionals in the securities community; and communications from federal, state or self-regulatory agencies. These differing pathways of intelligence were described along with the circumstances under which particular intelligence strategies are mobilized. The chapter concluded with an examination of the flow of intelligence inputs, the extent to which and the circumstances under which a given offense is generated by multiple detection strategies. The implications of the potential for multiple detection will be considered in the final chapter of the dissertation.

In this chapter, the theme of differential access has been the organizing principle around which detection strategies have been differentiated. Upon completion, the reader may legitimately question the value of this "access" notion. First I argue that access is all important, that the goal of enforcement should be to increase access. Then I suggest that too much access is not a good thing, that it limits perspective, and instead an intelligence system should strive for balance. Second, the analysis of the nature of the allegations of reactive sources seems to undercut the access notion: the distribution of allegations between access roles (i.e. insiders vs. investors) was often more similar than within access categories (i.e. actual vs. solicited investors). The sharing of access must not be all that meaningful if allegations are so different.

I would like to conclude this chapter by responding to these criticisms. The difficulty of relying on those detection strategies with greatest access to illegality, the subject of the first criticism, is one of sampling. Clearly,

the amount of intelligence concerning securities violations available to the SEC is only the smallest proportion of the universe of information pertaining to all such offenses. Now if one could assume that this intelligence sample was generated on a random basis, then the access implications are clear. SEC investigators should concentrate on that information disseminated by external roles with greatest access to illegality, "insiders," on the reactive side, and "incursions" on the proactive side. One could assume that such intelligence would be the fullest, the most unambiguous, and the most accurate.

But, obviously, a random sampling notion is absurd, and it is absurd in two respects. (1) There are most likely disproportionate amounts of information emanating from different access roles, with outsiders more likely and insiders less likely to communicate with the SEC. The "sampling fractions," then, differ by access role; the sample is unrepresentative. And it is also unrepresentative with regard to contributions from surveillance vs. from incursions. (2) More importantly, it is unlikely that the sample is representative within any given access role either. For structural, organizational, and pyschological reasons, some parties are more likely to refer information than others. Investors are more likely to complain to the SEC for offenses that leave them witting than for those which leave them unwitting. For some kinds of offenses, insiders are more likely to "rat" on other insiders than for others. In other words, the silent members of access roles may be quite unlike their vocal counterparts.

Hence, intelligence samples are extremely biased samples. Relying exclusively on those intelligence roles with greatest access and strategies with greatest incursive opportunities leaves one with a very small and a very trivial sample. It is small because one is relying on reactive inputs from those with the fewest incentives to share information and on proactive inputs based on the limited number of opportunities that the SEC has to intrude into the securities

world. It is trivial because a carefully organized offense will be designed to block any intrusive opportunities the agency could potentially exploit and to foreclose the possibility of insider disloyalty. Taken to a perhaps unrealistic extreme, one is left with an investigative sample of agency registrants whose books and records were in disarray when the SEC came to investigate and are culpable of technical recordkeeping violations and of organizational employees whose misbehavior - embezzlement, for example - was "tattled" on by other non-culpable insiders, their employers.

And so, in order to expand the perspective of an intelligence program, to compensate for an inherent and by and large unremediable sampling bias, it is necessary to seek greater balance in the employment and allocation of detection strategies. Hopefully, differences in incentives and perspective inherent in a fuller range of investigative sources will balance each other out and insure a wider if not more representative sample of offenses to pursue. The expansion of an intelligence program to more remote access strategies may introduce more noise into the system in the form of inaccurate or ambiguous allegations, and increase the cost of intelligence, but it may also increase the quantity and quality of offenses available for enforcement.

The second criticism charged that access distinctions cannot be very meaningful if the allegations <u>within</u> particular access roles tend to be more disparate than those <u>between</u> access roles. The response to this criticism is that a theory of access was not created to explain allegations. The reason for introducing the data on allegations in the chapter was to provide a fuller sense for the circumstances under which reactive investigative sources communicate with the SEC. Do they seek information? Have they been victimized? Do they wish to delegate enforcement responsibility? There is no reason why parties in different access roles should not find similar reasons to contact the SEC. We

argue that their perceptions are different, not necessarily their experiences.

Furthermore, allegations are not violations. The substance of allegations often bear only the most tenuous relationship to the actual pattern of behavior uncovered. And even where allegations correspond to reality and different access roles allege the same thing, that does not mean that the offenses are the same; they may be qualitatively quite different. The hypothesis is not that different access roles report different kinds of substantive violations. Rather, the hypothesis is that different access roles are more sensitive to or have greater perception over some offense vulnerabilities than others, and, therefore, their intelligence efforts will net offenses that differ qualitatively, on the dimensions along which offenses become vulnerable. And this hypothesis is tested in Chapters 6 and 7 with data, not on allegation, but on actual offense characteristics.

CHAPTER 6: GETTING CAUGHT: OFFENSE CORRELATES OF DETECTION STRATEGY

In this chapter and Chapter 7, questions about the relationship of characteristics of illegality to their detection, developed in Chapter 1, are examined empirically with the data on Securities and Exchange Commission investigations. Since the data pertain to detected illegalities only, they do not permit analysis of the likelihood of getting caught, but rather of how one is caught. An analysis of the latter will provide insights from which to speculate about the former, but consideration of detection probabilities will be at best speculative.

An analysis of the correlation of detection and behavior can focus on either of two perspectives. Detection strategy may be treated as the dependent variable, where analysis examines the question: Do characteristics of the organization and execution of illegality predict the manner in which it is detected? This perspective reflects the orientation of Chapter 1 of the dissertation, an attempt to understand how offense vulnerabilities facilitate particular detection methods. Or, detection strategy may be treated as the independent variable, where analysis examines the question: Do detection strategies differ in the kind of illegalities they uncover? This perspective is indifferent to the way in which offense vulnerabilities explain detection. Whatever that relationship or others which have escaped my theoretical formulation, this second perspective seeks to understand the impact of detection strategies as reflected in differences, if any, in the kinds of offenses they uncover. In the latter perspective, we attempt to appreciate the consequences of detection strategy; in the former to understand the choice of strategy. Strategy choice is the concern of this chapter, strategy consequences of Chapter 7.

The theoretical formulation in Chapter 1 described some of the common vulnerabilities of deviant behavior to intelligence - the diffusion of information, the observability and the residues of behavior - and hypothesized that they are related to detection opportunities. The chapter contained numerous examples of particular kinds of deviant or illegal behavior, from secret societies and witchcraft, to heroin dealing, organized crime, and police corruption, all mined for any insights they might provide toward understanding the peculiar vulnerabilities of white collar offenses. In this chapter, the focus narrows even further, to a concern for the vulnerabilities and invulnerabilities of securities violations and their implications for the organization of a system of intelligence.

With the diversity of securities violations over which the SEC has jurisdiction, a listing of all the implicit and explicit vulnerabilities found in this complement of offenses would be meaningless. But there are some major themes which characterize many securities violations. Most significant is the problem of the diffusion of information.

Securities transactions, whether licit or illicit, are fundamentally dependent on the flow of information. The securities marketplace is one in which the media of exchange, the currency, are essentially informational. The market is staffed by persons who are informational specialists about particular industries and by others who broker information. The tools of this industry are informational ones - prospectuses, annual reports, trade journals, stock quotations, tips. The "customers," the investors, make trading decisions on the basis of information concerning corporate business operations and prospects, concerning patterns in the overall market, the economy, and the like. The securities market is a transactional world based on tipsterism, rumor, gossip, eavesdropping - a world where people really do pick up investment tips from

overheard steambath conversations, where a television commercial can depict a huge noisy gathering becoming suddenly silent as one party repeats the advice of his stock broker to a friend.[1] In short, the securities industry owes its existence to information and its dissemination (as does the SEC). The need to restrict information or to halt its diffusion when transactions are illicit becomes a very difficult problem in a setting in which diffusion is the norm and for an offense which most likely relied on this diffusion to get off the ground in the first place.

Hence, in the securities world, informational diffusion - to a vast and diverse group - is the norm. Many securities violations are implemented by the collaboration of large staffs - whether they are manufacturing phony insurance policies as in the Equity Funding scheme (Dirks and Gross 1974, Soble and Dallos 1975), or shuttling around the world making illicit bribes and payoffs (McCloy 1975, Shaplen 1978), or "stealing from the rich" (McClintick 1977) by way of a fraudulent oil investment scheme. As the staff size of culpable participants grows, so too does the diffusion of information about illegal activities. Information becomes accessible to these culpable insiders, but might also become accessible to other organizational insiders who are non-participating, but proximate to their culpable counterparts.

Furthermore, many securities offenses occur in an inter-organizational context, where insiders from separate organizations - issuers, underwriters, brokers, investment advisors, accountants, attorneys, promotional firms, bankers, printers, journalists - may conspire in illegality. The culpablity of insiders in these organizations, and hence their access to information, may vary considerably. Some may in truth be "licit collaborators," a distinction

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[1]The steambath example comes from this research. The commercial: "Well, our broker's with E. F. Hutton, and he says... (sudden silence)." The commercial ends: "When E. F. Hutton talks, people listen."

suggested in Chapter 1. But whatever the distribution of culpability, there are few securities offenses that can be self-contained within a single organization. And to the extent to which other organizations are solicited to participate, information is diffused a little further. Finally, information must often diffuse to investors - if their commitment is to be secured - and to the SEC as well - if registration or other regulatory relationships must be activated to inaugurate the offense - providing additional detection opportunities. In short, as information salient to an offense diffuses to greater numbers of persons and organizations and to different kinds of parties, offenses tend to be more vulnerable to detection and to detection by various means.

A second kind of vulnerability found in many securities violations derives from the fact that they generate snatches of observable behavior and artifacts that are available for purposes of intelligence. Few of these behaviors and artifacts are widely disseminated, available to intelligence seekers who lack any access to settings of illegality. These few exceptions typically take the form of observable attempts to promote a particular security, through mass media advertising and reports touting the stock, and of artifacts of consummated securities transactions reflected in trading patterns of those securities traded on exchanges or over the counter. Other kinds of transactional behaviors and artifacts are less widely and publicly disseminated and are only available to parties with some access to these transactions - actual and potential brokers and investors, securities professionals, auditors, insiders, and the like. Examples of these latter potential intelligence sources include prospectuses, sales literature, and other mailings; telephone calls or personal communications; books and records, receipts, stock certificates, and the like.

In this chapter, the relationship of vulnerabilities of this kind to the

way in which offenses are detected is examined. Analyses will consider (1) the means by which offenses are executed and therefore the accessibility of their behaviors and artifacts, (2) the composition of offender groups and their relationships to investors and to the SEC and their implications for the nature and extent of the diffusion of information, (3) patterns of victimization, and (4) the subtlety or "apparency" of offenses, and their impact on intelligence.

Figure 6.1 is a prototype table similar to those most often presented in this chapter and Chapter 7 as well. It is a very complex table and, therefore, worthy of a few introductory comments. Part of this complexity derives from the substantial number of cells in the tables resulting from the many categories of detection under analysis. Another source of complexity in the tables derives from the fact that many cases have more than one "response" on a given variable. For example, more than a quarter of the investigations were instituted after being detected by more than one method. Since the divisor of salient percentages is the number of cases (not responses) in a class, the sum of percentages often exceeds 100. This characteristic of the tables (that cell totals do not equal row or column totals) also means that most summary statistics - which might otherwise simplify the analysis - are inappropriate.

As depicted in Figure 6.1, each table has three portions. The top portion contains six rows reflecting the most general source categories. The middle portion contains fifteen rows which break out the general sources into their more specific component parts. For example, (1) Surveillance (on top) is differentiated into (1) Market Surveillance and (1) Other Surveillance (in middle). When analysis focuses on only a few specific rows in a table, they will be darkened to simplify table reading. When the effect of a particular offense characteristic on detection strategy is examined, percentages are computed down the columns and they are compared across the rows. When case

FIGURE 6.1: DETECTION CORRELATES

	A	B	C	D	TOTAL
(1) Surveillance					
(2) Incursions					
(3) Insiders					
(4) Investors					
(5) Securities Community					
(6) Other Social Control Agencies					
(1) Market Surveillance					
(1) Other Surveillance					
(2) Inspections					
(2) Filings					
(2) Spin-offs					
(3) Participating Insiders					
(3) Self-Disclosures					
(3) Employers					
(4) Actual Investors					
(4) Solicited Investors					
(5) Informants					
(5) Professionals					
(6) Federal Agencies					
(6) State Agencies					
(6) Self-Regulatory Agencies					
TOTAL					
More Than One Source					
Different Sources					

differences by detection strategy are considered, this process is reversed: row percentages and column comparisons. In this chapter, most tables are of the former kind; in Chapter 7, they are of the latter kind.

The phenomenon of multiple investigative sources for a particular case was described in the last section of Chapter 5. As portrayed in Figure 6.1, the last two rows of a table present data for cases activated by more than one investigative source of any kind and by multiple sources that reflect different categories of the six category general classification on the top. If the source of investigation is the receipt of two separate letters of complaint from investors, this case would be counted in the category: "More Than One Source." If, instead, the case is generated by an investor complaint and disclosures by an insider, this investigation would be counted in both categories: "More than One Source" and "Different Sources." The N for the former category is 129 and for the latter, 94.

By monitoring the last two lines of tables of the kind portrayed in Figure 6.1, we can derive a sense for the offense and offender characteristics that are particularly vulnerable to detection, reflected in rates of multiple detection. These data might also serve as very rough indicators bearing on the "dark figure of crime." One may infer that offenses most likely overrepresented in the "dark figure" are those most unlikely to be detected more than once or by more than one method. The notion is that these offenses are least vulnerable to detection, and therefore most likely to be undetected. Inferences of this kind require one major analytic leap, however, the assumption that offenses more likely to be detected two or more times are also more likely to be detected at least once than those offenses less likely to be detected more than once. It is entirely plausible that offenses that tend only to be detected once are still

more likely to be detected than those that tend to be detected several times.[2] Still, these figures do bear insights on the vulnerability of particular offenses to detection.

The Media of Illegal Activity

The way in which illegal activities are executed affects access opportunities to information by non-participants in these activities. With respect to traditional forms of crime, this notion is reflected in Arthur Stinchcombe's discussion of "institutions of privacy" (1963), reviewed in Chapter 1. Where illegal activities are located in private places, police officers are denied detection opportunities through observation because of the institutional norms that protect private places.

It is unclear, however, what an "institution of privacy" is in the context of securities violations. Most of them continue over time, involve a number of social as well as spatial locations, a number of discrete actions, the involvement of numerous witting and unwitting perpetrators, facilitators, and victims. Although a discrete isolated act of embezzlement by a broker in his or her office, on the one hand, and the sale of bogus securities on a street corner by a con man, on the other hand, may illustrate the public/private distinction, most violations simply do not fit.

However, there are analogous distinctions about the execution of securities violations that are meaningful, and which bear on the means by which they can be detected. A distinction between "embodied" or "disembodied" access or

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[2]For example, the only way it may be possible to detect delinquencies in the filing of broker-dealer annual reports with the SEC is through scrutinizing SEC records and filings. But such a process may net 100% of all delinquencies. In contrast, offenses that defraud substantial numbers of investors may often generate three or four investor complaints per offense. But investors may complain at all in only 10% of all offenses of this kind. Hence, the dark figure is substantially greater in the latter than in the former offense.

communication is used in the literature on social interaction (Goffman 1963) and on social movements (Lofland 1966) to differentiate communicative messages transmitted by the human body and by other means that retain these messages after the human body stops informing, for example, between face-to-face and mass communication. The distinction is an appropriate one in the securities context as well, differentiating between transactions and communications that are face-to-face or embodied, for example, an individualized verbal sales pitch by a promoter to an investor, and those that are disembodied, for example, the use of prospectuses or newspaper advertising to promote a sale. Where the transaction itself rather than its promotion is salient, one might distinguish between face-to-face securities transactions between promotor and investor and securities transactions conducted over-the-counter or through a stock exchange. Although the distinction is a dichotomy, in this context it reflects a continuum that is bounded by fully embodied and private interactions and transactions, on the one hand, and by disembodied, wide-ranging, public communications and global transactional exchanges, on the other hand.

Clearly this distinction has ramifications for detection possibililties. It is extremely difficult for a "disinterested" third party to observe a discrete or episodic series of face-to-face encounters that involve illegality, and much simpler to observe public disembodied messages and transactions that pertain to that illegality. We recall from Chapter 5 that surveillance strategies, with little access to the settings of illegality, must rely on information that radiates beyond the activities themselves. Therefore, one might expect surveillance methods more common where the means of illegality involve disembodied messages than when they do not. At the other extreme, one would expect that securities investors, most often the targets of embodied messages and transactions, would be more likely to learn of illegality in this

fashion, than when undirected disembodied messages are transmitted or when they transact on faceless stock exchanges or through the mediation of their brokers. This hypothesis should be supported as well by the fact that victims may be more "witting" when experiencing embodied than disembodied messages and thus more likely to realize their victimization and complain about it.

An interesting contrast is the case of incursions. As a proactive strategy with greater access to illegality, one would expect disembodied messages less central to detection. However, embodied messages may not be any more accessible to these strategies which are permitted incursion, but usually retrospectively - after embodied communications and transactions have ended. It is possible, then, that the embodiment of communications may bear no relationship to incursions. In some respects, members of the securities community are in a similar structural position to the SEC incursion. They have greater access to illegality, but they are not participants. Hence they may be oblivious to certain wide-ranging disembodied messages and transactions, yet denied access to settings in which embodied ones occur.

Data were gathered pertaining to the means by which illegalities were executed and the nature of the communicative messages transmitted. Their relationship to detection strategy is displayed in Table 6.1. The embodied/disembodied criterion is arrayed from oral representations by offenders to victims to the use of public media: mass media advertising, newspaper articles, and stock market trading data. An intermediate category, reflecting disembodied means, but somewhat less public and less global dissemination, includes the use of prospectus type materials, sales literature, documents, opinion letters and the like. The top portion of Table 6.1 pertains to the general detection strategies; the middle portion breaks them out in greater detail. In this table, we inquire whether the proportion of cases generated by

TABLE 6.1: DETECTION AND THE MEDIA OF ILLEGAL ACTIVITY

% DOWN	ORAL REPRESEN-TATIONS		PROSPECTUS, LITERATURE		PUBLIC MEDIA		TOTAL CASES	
(1) Surveillance	20	15%	24	21%	22	42%	55	12%
(2) Incursions	28	20%	22	19%	12	23%	167	38%
(3) Insiders	11	8%	11	10%	3	6%	39	9%
(4) Investors	61	45%	44	38%	16	31%	126	29%
(5) Securities Community	16	12%	21	18%	6	12%	50	11%
(6) Other Social Control Agencies	47	34%	54	47%	21	40%	130	30%
(1) Market Surveillance	10	7%	6	5%	6	12%	22	5%
(1) Other Surveillance	10	7%	18	16%	16	31%	34	8%
(2) Inspections	7	5%	5	4%	2	4%	37	8%
(2) Filings	8	6%	7	6%	3	6%	96	22%
(2) Spin-offs	14	10%	11	10%	7	14%	41	9%
(3) Participating Insiders	7	5%	9	8%	2	4%	15	3%
(3) Self-Disclosures	3	2%	3	3%	0	0%	21	5%
(3) Employers	2	1%	0	0%	1	2%	4	1%
(4) Actual Investors	52	38%	33	29%	14	27%	105	24%
(4) Solicited Investors	13	9%	19	17%	8	15%	32	7%
(5) Informants	3	2%	4	4%	1	2%	22	5%
(5) Professionals	13	9%	17	15%	5	10%	28	6%
(6) Federal Agencies	9	7%	14	12%	5	10%	25	6%
(6) State Agencies	27	20%	28	25%	14	27%	59	14%
(6) Self-Regulatory Agencies	13	9%	13	11%	5	10%	47	11%
TOTAL	137		115		52		440	
More Than One Source	50	36%	49	43%	20	38%	129	30%
Different Sources	37	27%	42	37%	17	33%	94	22%

a particular detection strategy differs across categories of the media of illegality (percentagized down). Since a particular case may be generated by more than one detection strategy and more than one kind of medium, percentage totals may exceed 100 and the sum of row cells may exceed row totals.

The data in Table 6.1 solidly support the speculations about investigative source and the embodiment of illegal transactions. The proportion of cases detected by surveillance increases from 15% to 42% and by investors decreases from 45% to 31% as one moves from cases utilizing oral representations (embodied) to those utilizing public media (disembodied). A perusal of the lower portion of the table indicates that these relationships are even stronger when these categories are broken out. The surveillance relationship is contributed to especially by non-market surveillance. The investor relationship is based on actual investor referrals. Indeed, what differentiates actual from solicited investors is their greater opportunity to have face-to-face contact with offenders. The typical solicited investor referral comes from parties receiving high-pressure fraudulent sales literature about which they are inquiring with the SEC. What characterizes their experience is the absence of embodied contact, and that is reflected in the data.

Speculations about the relationship of incursions to the media of illegal activity receive some support from Table 6.1 as well. With the exception of spin-offs, which are somewhat more likely to reflect public media, the embodiment of communicative messages makes absolutely no difference for the likelihood of incursions. About a fifth of the cases in each media category were so detected. The findings with regard to referrals from the securities community also support previous speculations. Both professionals and informants are equally likely to refer matters involving oral representations and public media. However, lacking both the "microscopic" and "telescopic" perspectives on

illegal conduct, they are most likely to refer cases involving the intermediate category - the utilization of disembodied but limited media, prospectuses, literature, and the like. Twice the proportion (4% vs. 2%) of informant cases based on either public or private media, and one and a half times this proportion (15% vs. 10%) of professional communications involve cases of this kind.

A final insight can be gleaned from Table 6.1. That pertains to the multiplicity of detection strategies. The bottom two rows of the table indicate that cases are a bit more likely to be detected by more than one input of any kind, if they involve any of these communicative media (39%) than when they do not (30%). This is also true for inputs from different detection methods (32% vs. 22%). Offenses are especially likely to be detected more than once and by different methods (43% vs. 30% overall and 37% vs. 22% overall, respectively) where limited disembodied messages - prospectuses, literature, and the like - are employed. It is unclear what to make of these findings. Most plausibly, they suggest that as the execution of illegality becomes complicated or adorned by additional embellishments, communications, documents, etc. its vulnerability to detection is increased. We will follow through with this speculation in subsequent analyses, to see whether other indicators of complexity or embellishment increase the likelihood of getting caught more than once and by different means.

Offender Characteristics

Characteristics of the participants in illegal activity should bear a relationship to the way in which this activity is detected. This is so because offender characteristics are correlated with other attributes of illegality, which are themselves related to detection strategy. However, this is so as well because some kinds of offenders or constellations of offenders facilitate or

inhibit cover-up, on the one hand, visibility, on the other, to different audiences. It is this "causal" role that offender characteristics sometimes play in detection that is considered in this section. Several kinds of characteristics are examined: the scope and diversity of participants in illegality and the prior relationship of offenders to the SEC.

Offender Constellations

The recruitment of participants in illegal activity is a matter of fundamental concern for its architects. For all it takes is one disloyal, disaffected, or indiscreet participant to burst the bubble of an ongoing scheme, and to alert agencies of social control.[3] Most of the lore on the role of detection from inside sources assumes a psychological level of analysis, concerned with the characteristics of individuals or their experiences that cause them to "turn," a plausible notion, but one for which data are unavailable. However, a sociological perspective on this phenomenon seems appropriate as well. It would suggest that the size, scope, and organization of illegal activities create different problems of internal social control and of cover-up from outside scrutiny. Irrespective of individual psychologies, as the number of culpable participants increases, the concealment of illegality becomes increasingly problematic.

Although these "sociological" variables should be related to the likelihood of detection generally, they should be related particularly to detection based on surveillance and referrals by outsiders, since it is especially from those sources that cover-up is designed, and based on information provided by insiders, the actors in this "sociological" superstructure. With regard to this

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[3]Perhaps the most famous example of this phenomenon in the securities context is the discovery of the Equity Funding scandal (Dirks and Gross 1974). See also Shapiro 1978b for a detailed consideration of this matter in the context of cover-up.

research, one would expect strategies based on other surveillance, on the proactive side, and referrals from insiders, the securities community, and perhaps other social control agencies, on the reactive side, to be most responsive to vulnerabilities imposed by increasing scope of participation in illegality. Indicators of increasing scope, available in the dataset, include the number of alleged participants under investigation, the diversity of organizational roles they represent, and the number of different kinds of organizations from which they are drawn.

The hypothesis, a simplistic one, is that the proportion of larger, over-participated offenses detected by one of these strategies should be greater than that of smaller offenses which it uncovers. For example, when offenses entail the collaboration of different organizations - issuers, brokers, underwriters, other corporations - members of the surrounding securities community are more likely to learn of these activities than when offenses are contained in a single organization. Similarly, when an increasing number of offenders and specialized roles are associated with a particular scheme, their visibility to outsiders - social control agents or potential business associates - is enhanced. Furthermore, the possibility of referral from the inside is increased with the problem of control and supervision of these numerous disparate participants.

Of course, not only is the hypothesis simplistic but so are the data. They are barely sensitive to differences in scope. They contain no information on the organization of multiple participants, attention to and strategies of internal control, cover-up strategies and the like. The possibility that detection vulnerabilities of two offenses equal in scope may be entirely different because of differences in organization and control is incapable of exploration with these data. Hence these hypotheses may be disconfirmed because

they are inappropriate or because the data are insufficiently refined.

Tables 6.2, 6.3, and 6.4 present the data on the relationship of detection strategy to the number of individual participants, individual role diversity, and organizational diversity, respectively.[4] The tables are by no means spectacular, though perhaps supportive of this hypothesis overall. We look first to the detection by outsiders. As indicated in all three tables, non-market surveillance is slightly more likely to detect offenses with greater than with smaller scope. The proportion of cases detected by these means involving one versus three or more participants increases from 8% to 10%, of one versus more than one individual role increases from 7% to 10%, and of one versus more than one kind of organization doubles (6% vs. 13%). Apparently larger scope, particularly reflected in organizational diversity, facilitates surveillance efforts. On the reactive side, the relationship of scope to detection by other social control agencies is mixed. For self-regulatory agencies, for which surveillance of this kind is unusual, detection rates are negatively related to scope; for federal agencies, rates are unrelated to scope. State agencies do detect a somewhat higher proportion of offenses that involve numerous participants and diverse roles, but not those which involve diverse organizations.

The more interesting reactive strategies involve the securities community and insiders. Referrals by professionals are unaffected by individual scope, but rather by organizational scope. As the kinds of organizations diversify,

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[4]Different roles available to individual participants and distinguished in the dataset include those of corporate officer, sole proprietor, promoter, manager, salesperson, and other employee. Different kinds of organizations distinguished in the dataset include securities issuers, broker-dealers, investment advisors, investment companies, and miscellaneous other organizations. Individuals and organizations are considered diverse if individuals representing two or more roles or organizations of two or more kinds are under investigation in a particular case.

TABLE 6.2: DETECTION AND NUMBER OF OFFENDERS

% DOWN	ORGANIZATIONS ONLY		ONE PERSON		TWO PERSONS		THREE OR MORE PERSONS		TOTAL CASES	
(1) Surveillance	5	7%	19	12%	11	14%	20	16%	55	12%
(2) Incursions	43	58%	55	33%	26	34%	43	35%	167	38%
(3) Insiders	1	1%	14	8%	7	9%	17	14%	39	9%
(4) Investors	10	14%	47	28%	32	42%	37	30%	126	29%
(5) Securities Community	7	10%	19	12%	10	13%	14	11%	50	11%
(6) Other Social Control Agencies	18	24%	48	29%	21	27%	43	35%	130	30%
(1) Market Surveillance	3	4%	6	4%	6	8%	7	6%	22	5%
(1) Other Surveillance	3	4%	13	8%	5	7%	13	10%	34	8%
(2) Inspections	6	8%	17	10%	6	8%	8	7%	37	8%
(2) Filings	29	40%	32	20%	14	18%	21	17%	96	22%
(2) Spin-offs	8	11%	7	4%	8	10%	18	15%	41	9%
(3) Participating Insiders	0	0%	5	3%	4	5%	6	5%	15	3%
(3) Self-Disclosures	1	1%	6	4%	3	4%	11	9%	21	5%
(3) Employers	0	0%	3	2%	0	0%	1	1%	4	1%
(4) Actual Investors	5	7%	40	24%	24	32%	36	29%	105	24%
(4) Solicited Investors	6	8%	11	7%	10	13%	5	4%	32	7%
(5) Informants	3	4%	10	6%	4	5%	5	4%	22	5%
(5) Professionals	4	6%	9	6%	6	8%	9	7%	28	6%
(6) Federal Agencies	4	6%	11	7%	4	5%	6	5%	25	6%
(6) State Agencies	3	4%	19	12%	10	13%	27	22%	59	14%
(6) Self-Regulatory Agencies	9	12%	20	12%	4	5%	14	11%	47	11%
TOTAL	74		165		77		124		440	
More Than One Source	7	10%	43	26%	29	38%	50	41%	129	30%
Different Sources	7	10%	29	18%	22	29%	36	29%	94	22%

TABLE 6.3: DETECTION AND INDIVIDUAL DIVERSITY

% DOWN	ONLY ONE ROLE REPRESENTED		MORE THAN ONE ROLE REPRESENTED		TOTAL CASES	
(1) Surveillance	24	12%	23	16%	47	13%
(2) Incursions	74	36%	44	30%	118	33%
(3) Insiders	18	9%	20	14%	38	11%
(4) Investors	56	27%	59	40%	115	32%
(5) Securities Community	23	11%	18	12%	41	12%
(6) Other Social Control Agencies	66	32%	43	30%	109	31%
(1) Market Surveillance	9	4%	8	6%	17	5%
(1) Other Surveillance	15	7%	15	10%	30	8%
(2) Inspections	22	11%	9	6%	31	9%
(2) Filings	45	22%	18	12%	63	18%
(2) Spin-offs	11	5%	20	14%	31	9%
(3) Participating Insiders	7	3%	8	6%	15	4%
(3) Self-Disclosures	9	4%	11	8%	20	6%
(3) Employers	2	1%	2	1%	4	1%
(4) Actual Investors	46	22%	53	37%	99	28%
(4) Solicited Investors	16	8%	10	7%	26	7%
(5) Informants	10	5%	9	6%	19	5%
(5) Professionals	13	6%	9	6%	22	6%
(6) Federal Agencies	12	6%	8	6%	20	6%
(6) State Agencies	28	14%	28	19%	56	16%
(6) Self-Regulatory Agencies	26	13%	11	8%	37	10%
TOTAL	208		146		354	
More Than One Source	55	27%	64	44%	119	34%
Different Sources	40	19%	45	31%	85	24%

TABLE 6.4: DETECTION AND ORGANIZATIONAL DIVERSITY

% DOWN	ONE KIND OF ORGANIZATION		TWO OR MORE KINDS OF ORGANIZATIONS		TOTAL CASES	
(1) Surveillance	31	9%	24	25%	55	12%
(2) Incursions	132	38%	35	36%	167	38%
(3) Insiders	32	9%	7	7%	39	9%
(4) Investors	95	28%	31	32%	126	29%
(5) Securities Community	32	9%	18	19%	50	11%
(6) Other Social Control Agencies	107	31%	23	24%	130	30%
(1) Market Surveillance	10	3%	12	13%	22	5%
(1) Other Surveillance	22	6%	12	13%	34	8%
(2) Inspections	31	9%	6	6%	37	8%
(2) Filings	76	22%	20	21%	96	22%
(2) Spin-offs	28	8%	13	14%	41	9%
(3) Participating Insiders	13	4%	2	2%	15	3%
(3) Self-Disclosures	16	5%	5	5%	21	5%
(3) Employers	3	1%	1	1%	4	1%
(4) Actual Investors	81	24%	24	25%	105	24%
(4) Solicited Investors	21	6%	11	12%	32	7%
(5) Informants	16	5%	6	6%	22	5%
(5) Professionals	16	5%	12	13%	28	6%
(6) Federal Agencies	17	5%	8	8%	25	6%
(6) State Agencies	49	14%	10	11%	59	14%
(6) Self-Regulatory Agencies	42	12%	5	5%	47	11%
TOTAL	344		96		440	
More Than One Source	89	26%	40	42%	129	30%
Different Sources	62	18%	32	34%	94	22%

the proportion of referrals by professionals more than doubles (5% vs. 13%). Referral patterns by informants are unaffected by scope. Finally, insider referral patterns, reflected in detection by participating insiders and self-disclosures,[5] conform somewhat to hypotheses that correlate increased reporting with increased scope. Proportions of referrals from both sources increase somewhat with increasing numbers of participants (3% to 5% for participating insiders, 4% to 9% for self-disclosures) and especially with greater diversity of organizational roles, with proportions doubled when more than one role is involved. However, their referral behavior is unrelated to organizational diversity. In other words, as might be expected, increasing intra-organizational scope facilitates reporting by insiders, inter-organizational scope facilitates reporting by outsiders in the securities community as well as surveillance efforts.

It should also be noted from the bottom two rows of the tables that increasing scope - both intra- and extra-organizational is related to multiple detection. For both multiple detection of any kind and by different sources, the proportion of cases of greater scope - individual or organizational - detected by these means is at least one and a half times higher than that of cases of lesser scope. Indeed the proportion of cases involving diverse organizations detected by different means is almost double that (34%) of cases involving single organizations (18%).

These data reveal a slight tendency, then, for increased participational scope to be accompanied by increased detection by certain outsiders and insiders. A word about the relationships not covered by the hypothesis is in order. Incursions fairly systematically reflect a negative relationship between

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[5]Employers refer matters (usually embezzlement) pertaining to single employees and therefore, their reporting is not relevant to this analysis.

scope and detection. Although not expected, investor referrals bear a positive relationship to diversity of both individuals and organizations - 13% more likely to refer cases with diverse roles and 4% more likely with diverse organizations. In short, scope facilitates detection from the outside, because of increased visibility and referral from the inside because it accentuates the possibility of individual disloyalty or indiscretion. In other words, scope tends to be positively related to most everything but incursions. If so, it does little to discriminate detection strategies or to differentiate their catch. These indicators of scope of participation are extremely gross, however. More refined measures may indeed bear more meaningful relationships to detection strategy.

Offender Relationships with the SEC

Offenses enacted by parties with prior relationships to the SEC should be more vulnerable to proactive intelligence than should unrelated parties. This hypothesis is examined with respect to two kinds of prior relationships, that of being an agency registrant and that of being a former subject of SEC enforcement (hence, a recidivist). A primary indicator of SEC prior relationships with offenders is reflected in their registrant status with the Commission. One might expect that proactive detection efforts would be more successful where at least one participant in illegality is registered with the Commission than where none are, since this status means that SEC staff are aware of the existence of an organization and are afforded some opportunities of incursion. Registrant status should be considerably less relevant in accounting for the catch of reactive detection strategies, since this status has little bearing on the likelihood that they will be drawn into a securities transaction or on the quality of information obtained. Of course, these hypotheses are self-fulfilling. Since several kinds of offenses are directly correlated with

registrant status - either involving failure to register, fraud in the registration process, or violation of technical rules applicable only to registrants - detection strategies based on registration are more likely to catch offenses of this kind. The true test of the relationship between proactive detection and prior relationship to the SEC is whether, for offenses in which registration is irrelevant, such as securities fraud, the registered status of one or more participants affects how offenses are detected.

The data clearly support this hypothesis. Fifteen percent of the fraud cases in which neither issuer nor broker were registered were detected by surveillance or incursions in contrast to 40%, in which one or both parties were registered with the Commission. These figures were 74% and 42%, respectively, for offenses caught by reactive methods and 11% and 18% for those detected both reactively and proactively. Table 6.5 displays the relationship of detection and registration (securities fraud only) for each of the categories of detection strategy. As the first two rows of the table indicate, surveillance is responsive only to the registered status of stock issuers (detecting offenses of 28% of registered issuers and 12% where there were no registered issuers); incursions are sensitive to the registered status of both issuers and brokers. Incursions detect only 12% of those offenses in which none of the participants are registered, in contrast to 34% of those with registered issuers, 47% with registered brokers, and 62% where both are registered. As indicated in the middle portion of the table, inspections account for catching broker-dealer offenses, filings primarily those of issuers.

As we think back to Chapter 5, which described the nature and implementation of the proactive detection measures, it is not surprising that their catch is primarily composed of SEC registrants. Market surveillance monitors trading of registered securities; inspections are conducted only of

TABLE 6.5: DETECTION AND SEC REGISTRATION (SECURITIES FRAUD ONLY)

% DOWN	NEITHER ISSUER NOR BROKER REGISTERED		ISSUER REGISTERED		BROKER-DEALER REGISTERED		BOTH ISSUER AND BROKER REGISTERED		TOTAL CASES	
(1) Surveillance	21	15%	16	29%	7	8%	7	27%	51	16%
(2) Incursions	17	12%	19	34%	42	47%	16	62%	94	30%
(3) Insiders	14	10%	9	16%	10	11%	0	0%	33	10%
(4) Investors	55	39%	12	21%	32	36%	10	38%	109	35%
(5) Securities Community	26	18%	5	9%	9	10%	6	23%	46	15%
(6) Other Social Control Agencies	62	44%	16	29%	23	26%	2	8%	103	33%
(1) Market Surveillance	5	4%	8	14%	4	4%	5	19%	22	7%
(1) Other Surveillance	16	11%	9	16%	3	3%	2	8%	30	10%
(2) Inspections	0	0%	0	0%	26	29%	3	12%	29	9%
(2) Filings	6	4%	14	25%	8	9%	10	38%	38	12%
(2) Spin-offs	12	9%	8	14%	10	11%	3	12%	33	11%
(3) Participating Insiders	8	6%	4	7%	3	3%	0	0%	15	5%
(3) Self-Disclosures	6	4%	5	9%	4	4%	0	0%	15	5%
(3) Employers	1	1%	0	0%	3	3%	0	0%	4	1%
(4) Actual Investors	48	34%	10	18%	27	30%	8	31%	93	30%
(4) Solicited Investors	12	9%	4	7%	8	9%	3	12%	27	9%
(5) Informants	10	7%	2	4%	5	6%	2	8%	19	6%
(5) Professionals	16	11%	3	5%	4	4%	4	15%	27	9%
(6) Federal Agencies	15	11%	6	11%	2	2%	0	0%	23	7%
(6) State Agencies	37	26%	6	11%	7	8%	1	4%	51	16%
(6) Self-Regulatory Agencies	14	10%	5	9%	12	14%	0	0%	31	10%
TOTAL	142		56		90		26		314	
More Than One Source	47	34%	23	41%	32	36%	12	46%	114	37%
Different Sources	36	26%	18	32%	24	27%	12	46%	90	29%

registered broker-dealers; filings are made only by registrants. What is noteworthy about these data is how unlikely these strategies are to generate information about unregistered associates of these parties, and how unsuccessful proactive methods unrelated to registration status are. For example, despite previous discussion of the richness of broker-dealer inspections - that one can learn a great deal about the conduct of other parties conducting or attempting to conduct business with them - not a single fraudulent offense by an unregistered party or by a registered issuer acting alone was caught during a broker-dealer inspection.

For both other surveillance and spin-offs, registrant status is irrelevant. The public conduct of all organizations, displayed in the press, litigation, and the like, is monitored by non-market surveillance. But this strategy is only slightly more likely to detect offenses of nonregistrants (11%) than registrants (8%). New investigations can be spun-off from any SEC case. But while 45% of all SEC investigations for securities fraud involve non-registrants, spin-off cases involve only 36%. In other words, the insensitivity of SEC proactive detection strategies to offenses of non-registrants is not due solely to the organization of these strategies around the registrant relationship.

As the data demonstrate, then, proactive methods are not especially successful in detecting offenses by non-SEC registrants. As expected, this is not the case for reactive sources of investigation, where registrant status is, if anything, inversely related to detection. For each of the overall categories of reactive methods, presented in the top portion of Table 6.5, the proportion of cases in which offenders are unregistered is about the same or higher than where at least one is registered, respectively, 10% and 11% for insiders 39% and 31% for investors, 18% and 12% for the securities community, and 44% and 24% for other social control organizations. The weak relationship for insiders is

accounted for by the fact that non-participating insiders who make disclosures about illegality to the SEC tend to be drawn from registered organizations. Of course, there is variability across particular reactive sources in their responsiveness to offender registered status and to particular categories of registration. For example, state agencies are especially unlikely to refer matters involving any registered party (8% vs. 26%), actual investors are especially unlikely to refer matters involving registered issuers (22% for registered issuers, 30% for registered brokers, 34% for unregistered parties).

Despite the particularistic variability across the table, the important point is that proactive methods are unlikely to detect offenses by unregistered parties, for which reactive methods are better suited. Another finding is that offenses by unregistered parties are slightly less vulnerable to multiple detection than registered parties - especially issuers and issuers coupled with broker-dealers. As reflected in the bottom two rows of the table, unregistered parties have a 34% chance of being caught more than once, which increases to 36% if a registered broker participates in illegality, to 41% with the participation of registered issuers, and to 46% with the participation of both registered issuers and brokers. These figures are 26%, 27%, 32%, and 46% respectively, for the likelihood of being caught by two or more different detection methods. Failure to register, then, may shield offenders from proactive detection methods and from multiple detection.

Another indicator of prior relationships is reflected in recidivism. Some parties investigated for securities violation - at least 43% of them[6] - have been subject to previous investigations, much of them also conducted by the SEC. Just as registrant status provided a handle on which proactive detection methods could be organized, recidivism could also facilitate proactive efforts. Given

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[6]See Chapter 4 for further discussion of recidivism.

the assumption that offenders are more likely than non-offenders to be future violators, investigators might more carefully scrutinize the conduct of the former than the latter in detection efforts. One might hypothesize, therefore, that the proportion of investigations involving recidivists detected by proactive methods should be higher than those of non-recidivists.

This notion was examined with data from the research, which contrasted the proportion of cases uncovered by each detection strategy in which at least one participant was a known recidivist (N=241) and in which none of the participants were known recidivists (N=199). These data are presented in Table 6.6. The analysis soundly disconfirms this hypothesis. A relationship between detection and recidivism is barely perceptible, and it is in the opposite direction expected. Proactive strategies are slightly less likely (by 2% or 3%) to detect offenses involving recidivists. Only spin-offs are more likely to generate investigations of this kind, with the proportion of recidivist cases double that of non-recidivist cases. But this finding is really self-fulfilling since, in order to be the subject of a spin-off, some participant had to be involved in a prior investigation.

On the reactive side, we find, contrary to expectation, that actual investors are more likely to refer offenses by recidivists (29%) than non-recidivists (18%). This finding probably reflects the fact that investors are more often victimized by recidivists than by non-recidivists. It is unlikely that victims are aware of the recidivist status of offenders or that it affects rates of complaint. The table also indicates that recidivism is central to referrals from federal agencies. The proportion of recidivist cases they referred (8%) is over three times that of non-recidivist cases (2%). Again this finding may be self-fulfilling, since the subjects of these referrals may already be under investigation for other federal offenses. Information

TABLE 6.6: DETECTION AND RECIDIVISM

% DOWN	NO RECIDIVISM		SOME RECIDIVISM		TOTAL CASES	
(1) Surveillance	28	14%	27	11%	55	12%
(2) Incursions	74	37%	93	39%	167	38%
(3) Insiders	17	9%	22	9%	39	9%
(4) Investors	46	23%	80	33%	126	29%
(5) Securities Community	23	12%	27	11%	50	11%
(6) Other Social Control Agencies	51	26%	79	33%	130	30%
(1) Market Surveillance	12	6%	10	4%	22	5%
(1) Other Surveillance	17	9%	17	7%	34	8%
(2) Inspections	18	9%	19	8%	37	8%
(2) Filings	46	23%	50	21%	96	22%
(2) Spin-offs	12	6%	29	12%	41	9%
(3) Participating Insiders	5	2%	10	4%	15	3%
(3) Self-Disclosures	10	5%	11	5%	21	5%
(3) Employers	2	1%	2	1%	4	1%
(4) Actual Investors	35	18%	70	29%	105	24%
(4) Solicited Investors	14	7%	18	8%	32	7%
(5) Informants	10	5%	12	5%	22	5%
(5) Professionals	13	7%	15	6%	28	6%
(6) Federal Agencies	5	2%	20	8%	25	6%
(6) State Agencies	24	12%	35	15%	59	14%
(6) Self-Regulatory Agencies	23	12%	24	10%	47	11%
TOTAL	199		241		440	
More Than One Source	43	22%	86	36%	129	30%
Different Sources	29	15%	65	27%	94	22%

generated by these federal investigations led to the referral to the SEC.

Though few specific detection strategies bear a strong relationship to recidivism, they do in the aggregate. As indicated in the bottom two rows of Table 6.6, offenses involving recidivists are a good deal more likely to be detected more than once and by different sources than are those involving non-recidivists. Percentage differences are 14% and 12%, respectively. These data indicate, then, that aside from the spin-off of investigation from investigation, SEC investigators either do not utilize prior record as a strategy of searching for illegal conduct or that such activity bears little fruit. Most likely, the former is a more accurate conclusion. In any event, for whatever reason, detected offenses by recidivists are more vulnerable to multiple detection than those of non-recidivists.

Victimization

What is the effect of the generation of victims on the way in which an offense is detected, particularly its impact on investor complaints? Of course, not all securities violations generate victims or patterns of victimization that entail economic loss. This is the case for many technical regulations required of registrants - about the filing of financial reports, books and records, net capital levels - as well as for the simple failure by professionals or stock issuers to register with the Commission. However, the matter of victimization is problematic for some fraudulent activities as well. Fraud may consist of attempts to bypass regulatory requirements or to conceal previous sanctions and restrictions, through the use of nominees, fronts, and the like, but the securities transactions conducted by these parties may be fully licit. Some fraudulent schemes may be so amateurish or so readily detected and halted, that investors do not have the chance to be victimized. In some schemes, investors actually make money, perhaps because a favorable market camouflages their

potential losses or because they got out early. For other offenses, of manipulation, self-dealing, embezzlement or misappropriation, and the like, parties have been victimized, but they are difficult to enumerate. They may be stock purchasers, sellers, or shareholders, or hold some combination of these statuses during the period of an on-going violation. If the investigators, with the luxury of hindsight, have difficulty enumerating victims, it is no wonder that victims themselves have difficulty recognizing their plight as the illegality unfolds.

Victimization, then, is a slippery concept in this context and the shades and qualities of victimization generated by securities violations are by no means uniform. Perhaps this is why the victim of securities violations is a relatively less important investigative source than his or her counterpart in the context of street crime. Even if one assumes that all actual investors, all non-participating insiders, all informants and members of the securities community were victims - which clearly is not true or even reasonable - they would account for the initiation of only 41% of all SEC investigations, in contrast to perhaps double that proportion for police mobilizations.[7] In any event, the victim generating capacity of an offense and the victim referral component of detection strategies are clearly problematic in this setting. They are explored in this section in which we inquire about the impact of victim generation on the process of getting caught.

In Chapter 4, the data available in this research on the extent and quality of victimization were described. For purposes of the present analysis, a distinction is made between offenses for which there were no victims, for which victims could be specified, and for which it is unclear whether there were

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[7]Of course, some matters referred by other social control agencies orginated in victim complaints.

victims or it is impossible to enumerate them. This latter category contains cases for which victimization is an inappropriate concept as well as those for which it is appropriate, but for which data on victimization were unavailable. It is one of the very unfortunate shortcomings of the coding process that these cases were not distinguished. Nonetheless, these three categories can be thought of as forming a continuum, ranging from no victimization to victimization.

The relationship of this tripartite variable to detection strategy is presented in Table 6.7. As the top portion of the table indicates, with the exception of incursions, which reflect a dramatic negative relationship to victimization, the presence of victimization increases the likelihood that an offense will be caught by all remaining detection strategies, and indeed, that it will be detected by more than one and by different strategies. However, most of these findings are artifacts of other relationships. Of appropriate interest are rows (4) and (6) in the table. Row (4) is relevant, of course, because investors are the typical victims of securities violations; row (6) because, as we learned in Chapter 5, victim complaints are a common (almost half) source of referrals from other social control agencies. Here we ask the perhaps obvious, but necessary question: Are referrals from these parties affected by the fact of victimization?

The answer, of course, is yes - but with qualifications. Investors are four times more likely (44% vs. 11%) to refer offenses that created victims than those which do not. However, this is true only for <u>actual</u> investors (and presumably <u>actual</u> victims), for whom the relationship is stronger (39% vs. 6%). Solicited investors are only a bit more likely to refer matters when there is victimization (8% vs. 5%). This reflects the fact that they are but <u>solicited</u> victims; they refer matters to the Commission prior to transacting with

TABLE 6.7: DETECTION AND VICTIMIZATION

% DOWN	NO VICTIMS		VICTIMS NOT ENUMERATED		VICTIMS ENUMERATED		TOTAL CASES	
(1) Surveillance	10	6%	25	23%	20	12%	55	12%
(2) Incursions	94	59%	41	37%	32	19%	167	38%
(3) Insiders	10	6%	11	10%	18	11%	39	9%
(4) Investors	17	11%	34	31%	75	44%	126	29%
(5) Securities Community	14	9%	11	10%	25	15%	50	11%
(6) Other Social Control Agencies	32	20%	33	30%	65	38%	130	30%
(1) Market Surveillance	6	4%	13	12%	3	2%	22	5%
(1) Other Surveillance	5	3%	12	11%	17	10%	34	8%
(2) Inspections	14	9%	14	13%	9	5%	37	8%
(2) Filings	71	46%	14	13%	11	6%	96	22%
(2) Spin-offs	11	7%	16	15%	14	8%	41	9%
(3) Participating Insiders	1	1%	5	5%	9	5%	15	3%
(3) Self-Disclosures	9	6%	6	6%	6	4%	21	5%
(3) Employers	0	0%	0	0%	4	2%	4	1%
(4) Actual Investors	10	6%	28	26%	67	39%	105	24%
(4) Solicited Investors	8	5%	10	9%	14	8%	32	7%
(5) Informants	9	6%	4	4%	9	5%	22	5%
(5) Professionals	5	3%	7	6%	16	9%	28	6%
(6) Federal Agencies	5	3%	10	9%	10	6%	25	6%
(6) State Agencies	7	4%	14	13%	38	22%	59	14%
(6) Self-Regulatory Agencies	17	11%	7	6%	23	14%	47	11%
TOTAL	159		110		171		440	
More Than One Source	20	13%	48	44%	61	36%	129	30%
Different Sources	14	9%	35	32%	45	26%	94	22%

offenders. This finding suggests that it is not only by virtue of victimization that parties cast in investor roles refer matters to the SEC, though the fact of victimization certainly increases the likelihood of this response.

The data in column (6) also indicates a positive relationship between victimization and referrals by other social control agencies, with proportions increasing from 20% to 38% of the cases without and with victims, respectively. The bottom portion to the table suggests that although this relationship is positive for all three agency categories - federal and state agencies and self-regulatory agencies - it is strongest for state agencies, where the proportion of victim cases is five and one half times higher (22%) than that of no victim cases (4%).

The likelihood that investors or other social control agencies will be the source of investigation also increases as the number of victims generated by an offense increases, though not as dramatically as one might expect. The proportion of referrals where there are less than twenty-six victims in contrast to more than one hundred victims is 42% and 49% for investors and 35% and 43% for other social control agencies. The relationship is stronger for solicited than actual investors and strongest for state agencies. The expectation of a stronger relationship between the number of victims and rates of referral was based on the assumption that it takes only one referral to institute an investigation, and as the number of victims increases, the opportunity for complaint is multiplied. The fact that the relationship is relatively weak suggests that there may be differences in victim experiences in "big" and "little" offenses that differentially predispose them to make complaints.

One strong relationship does emerge from this analysis: The likelihood of multiple investigative sources and inputs from different sources is substantially increased as the number of victims increases, from 29% where there

are less than twenty-six victims to 55% where there are more than one hundred for multiple sources, and from 18% to 43% for different sources. This relationship is most likely spurious: The extent of victimization is correlated with other indicators of the nature and complexity of an offense which enhance the likelihood of being caught.

Table 6.7 provided several insights: Investors are much more likely to refer matters to the SEC when someone (if not themselves) has been victimized, but investors will refer matters in the absence of any victimization as well. The table also suggests that for a substantial number of cases (almost half) in which victimization is clear (79 of 203) or likely (87 of 140) offenders are caught by means other than investor complaints directly or mediated by other social control agencies. This is supplemented by the finding that the rate of investor complaints does not increase substantially with an increasing number of victims and the speculation that different kinds of victimizing offenses may predispose investors to respond differently. All of these insights lead to a single question: Why do victimized investors not complain? This cannot be examined directly, since data on all unreferred illegalities are inherently unavailable. However, a related analysis of this question based on offenses detected by other means can be conducted. Analysis will consider the economic cost of victimization, victim and offender relationships, and the subtlety of offenses.

The Economic Cost of Victimization

A plausible hypothesis, and one given some credence by studies of the reporting of property crimes to the police,[8] is that investor reporting behavior is positively correlated with the monetary extent of victimization. Although

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[8]See Chapter 1.

there may be the occasional big investor who fails to complain by virtue of embarrassment, it is likely that as his loss increases, the incentive to do something about the victimization (one alternative of which is to bring in the SEC) increases. This hypothesis would suggest that where offenses result in victimization, the proportion of investigations instituted as a result of investor complaints should increase as the economic cost of victimization increases.

Data are available to test this hypothesis. Table 6.8 presents a cross-tabulation of investor referrals by estimates of the amount of money involved in illegality[9] for these offenses that resulted in victimization. The table breaks down investor complaints into those by actual and by solicited investors and differentiates offenses that clearly generated victims from those for which victimization is questionable. It really matters little how many discriminations are made. The table casts considerable doubt on the plausibility of this hypothesis. At worst, there is no relationship at all; at best, it is curvilinear, with victims unlikely to complain about small victimizations (under $5,000), but much more likely to complain where somewhat larger amounts are involved ($5,001 - $25,000) or extremely large amounts are involved (over $500,000).

Perhaps the ambiguity of these findings results from the fact that the hypothesis pertained to individual incentives, yet the data aggregated behavior by offense. Therefore, an estimate of per capita victimization was calculated, a rather gross measure pertaining only to those cases (N=181) for which precise data were available both on number of victims and economic magnitude of the offense. Per capita cost ranged from under $500 (31%) to in excess of $50,000 (12%); about half of these investors lost less than $1,000. The per capita

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[9]See Chapter 4 for an elaboration of this variable.

TABLE 6.8: INVESTOR COMPLAINTS AND THE COST OF VICTIMIZATION

% DOWN:		$1 - $5,000		$ 5,001 - $25,000		$ 25,001 - $100,000		$100,001 - $500,000		$500,001+		TOTAL	
Investors:	Victims Enumerated	(3)	25%	(17)	59%	(24)	48%	(14)	28%	(13)	57%	(71)	43%
Investors:	Victims Not Enumerated	(1)	50%	(1)	11%	(7)	44%	(4)	29%	(6)	40%	(19)	34%
Actual Investors:	Victims Enumerated	(2)	17%	(15)	52%	(22)	44%	(12)	24%	(13)	57%	(64)	39%
Actual Investors:	Victims Not Enumerated	(1)	50%	(1)	11%	(6)	38%	(4)	29%	(6)	40%	(18)	32%
Solicited Investors:	Victims Enumerated	(1)	8%	(3)	10%	(3)	6%	(3)	6%	(3)	13%	(13)	8%
Solicited Investors:	Victims Not Enumerated	(0)	0%	(1)	11%	(1)	6%	(1)	7%	(2)	13%	(5)	9%
Total Cases:	Victims Enumerated	(12)		(29)		(50)		(50)		(23)		(164)	
Total Cases:	Victims Not Enumerated	(2)		(9)		(16)		(14)		(15)		(56)	

analysis does not rehabilitate the hypothesis. The relationship remains curvilinear. In cases for which there are both victims and economic loss, investors are no more likely to be the source of an SEC investigation as per capita magnitude of loss increases than are other detection strategies. Indeed, if anything, investors are somewhat less likely to complain as magnitude increases, relative to other sources.

These are very important findings. Although they do not necessarily decimate notions concerning economic incentives in reporting, they suggest that, regardless of the veracity of these notions, other factors must militate against (or facilitate) victim referrals. Two possible factors, concerned with victim offender relationships and the subtlety or ambiguity of offense, are considered below.

Victim Offender Relationships

An important area of inquiry in the study of the mobilization of the police by citizens pertains to victim offender relationships. Research findings indicate that the likelihood that the police will be called and that a subsequent arrest will be made increases with the "relational distance" between victim and offender. This finding is explained by the absence of alternative mechanisms of social control or dispute resolution between strangers, often available to intimates (Black 1971). Chapter 4 describes victim offender relationships in securities violations, noting the surprising frequency of cases in which they had prior relationships of some sort. Perhaps the absence of investor complaints for offenses that do generate victims derives from prior relationships and either the reticence of victims to report on acquaintances or the belief that they can resolve their grievances without formal intervention.

Table 6.9 presents the cross-tabulation of victim offender relationships with investor referrals. These data generally disconfirm these speculations.

Although it is true that the lowest proportion of investor referrals is found among cases in which victims and offenders were family members or close friends (31%), relational distance does not account for other reporting behavior.

TABLE 6.9: INVESTOR COMPLAINTS AND VICTIM AND OFFENDER RELATIONSHIPS

(% Across)	Actual Investors		Solicited Investors		All Investors		Total Cases
Victim and Offender - Strangers	(27)	39%	(12)	17%	(34)	49%	(69)
Victim and Offender Previously Related	(18)	47%	(0)	0%	(18)	47%	(38)
Victim and Offender - Family or Friends	(5)	31%	(0)	0%	(5)	31%	(16)

Actual investors are somewhat more likely to refer cases pertaining to the conduct of persons they know (47%) than of strangers (39%). The fact that solicited investors only refer offenses conducted by strangers is almost definitional - that is the kind of relationship that leads to solicitation. In any event, excluding family and friends, the relationship is either non-existent or counter-intuitive. And even in the case of true intimates, one would have expected a substantially lower rate of referral than was found. Victim offender relations do not seem particularly central to the process of referral. Most likely this is the case because relationships are correlated with other offense characteristics that are more central to this process.

The Apparency of Illegality

Of course, one of the reasons victimized investors may not lodge a complaint with the SEC or another social control agency is that they are unwitting. They are simply unaware that they have been victimized and most likely unaware that unorthodox behavior of any kind is underway in corporations in which they are actual or potential stockholders or clients.

In the case of street crime, it is a rarity that there is much ambiguity about the possibility that a criminal event warranting some investigation has occurred. Further investigation may be necessary before it can be ascertained that a corpse with a bullet in its head was the victim of first-degree murder, manslaughter, or suicide, or whether a participant in sexual intercourse was actually raped. The definition of a criminal event may require considerable inquiry, then, with regard to circumstances and motives, but it is relatively clear when an event warrants such inquiry.

This is rarely the case for securities violations. One receives a prospectus which favorably characterizes a corporation issuing securities. All prospectuses, generated by licit as well as illicit stock promotions, tend to reflect favorably upon a corporation. There is no inherent reason to suspect illegality. A client instructs his or her stock broker to purchase a particular security and hold the certificates in safekeeping. Subsequently, the client receives a confirmation of the transaction and periodic dividend checks for the investment. He or she has no way of knowing that they are bogus and that the broker had never made the transaction and pocketed their monies. Clearly, even these offenses vary in their ambiguity or subtlety. The prospectus with incredibly optimistic projections, with spelling mistakes and mathematical errors on its financial sheets may be of a dead giveaway of a fraudulent scheme, as may the use of handwritten stock confirmations or of the broker's personal

checks to transmit corporate dividends.

The fact that a particular act or series of acts constitutes a potential securities violation may not be apparent because of the complex and technical nature of such transactions, because suspicions often require information typically unavailable to non-offenders, because such transactions often pertain to a future event and thus require the passage of time for illegallity to become apparent, because offenses may involve self-dealing rather than outright theft and thus there may be no missing commodities to signal its occurrence, or because attention to deception and cover-up may conceal its illicit qualities. In any event, securities violations are variable in their "apparency," but the possibility of offense ambuiguity is considerably more likely than is the case for street crimes.

This discussion concerns what I call, the "apparency" of an offense, the extent to which illegal activities are apparent to non-participants with access to some amount of information. Apparency includes such characterizations as the subtlety, ambiguity, or clarity of illegal activities. Where offenses are not apparent, it is likely that many classes of outsiders, including victims, may be unwitting, that detection may be rather problematic. The apparency of violative behavior is clearly related, then, to detection probabilities. Indeed, much <u>undetected</u> illegality may be extremely subtle and well concealed; it may not be apparent. However, the apparency of illegality should also be related to investigative source for offenses that <u>are detected</u>. Apparency should be more critical for outsiders than for insiders, who presumably know what it is they are doing despite appearances. Furthermore, some classes of outsiders should be better able to overcome the obstacles of apparency; they are better trained to penetrate the subtleties and ambiguities of offenses and to determine their essential qualities. Thus, apparency should be more critical for reactive

methods than for proactive methods (reflecting SEC expertise), moreso for investors than for securities professionals, and so on.

A truly satisfying anaylsis of this phenomenon would require an in-depth consideration of the myriad ways in which offenses can be ambiguous or subtle - from the complex and technical nature of the transactions and organizations involved, to the role of spatial, temporal, and interpersonal distancing in executing these offenses, to the sophistication of offenders, to the vagaries and subtleties of concealing, deceiving, and covering up these offenses during or subsequent to their execution, including the use of nominees, the laundering of funds, the manipulation of books and records, and the like. It is extremely difficult to code these complex and subtle distinctions meaningfully across a large sample of disparate cases. Regardless of difficulty, the fact is that the data collected are considerably less rich than one would like.

An analysis of apparency should consider data of two kinds: one pertains to elements of the means by which offenses are executed, the other to classes of illegality that tend to be more apparent than others, irrespective of the conduct of the illegal activity in the particular case. The former kind of data is unavailble in this research. This analysis will therefore only examine data of the latter kind. It will consider which classes of illegality are more apparent than others and how these differences are related to investigative source.

Despite one's degree of access to settings of illegality, many securities violations go undetected because they are not apparent. Misrepresentations look the same as representations. Self-dealing looks the same as the more licit "other-dealing." Insider trading looks the same as normal securities trading. Unfair pricing policies, excessive mark-ups and commissions, and churning by a stock broker in a discretionary account may look the same to an investor as more

businesslike and honest discretionary behavior. Because many securities offenses are not zero-sum, do not incur a loss to victims commensurate with the gain to offenders, victims may not recognize or realize their victimization. These offenses are not apparent. The victims' dealings have a "licit" appearance. For the kinds of offenses in the research sample, those of stock manipulation, self-dealing, misappropriation of funds, and misrepresentation best represent the extremes of apparency. Their relationship to detection is examined below.

Tables 6.10 through 6.12 present data that bear on this question. Data are presented for all detection strategies, although the analytic role of some of them is unclear. For example, offense apparency should be irrelevant for insiders in illegal activity, since presumably they know what they are doing. Although one might therefore expect insiders to refer a higher proportion of the less apparent offenses detected, other phenomena, pertaining to the few incentives for self-reporting, may obscure this relationship. It is unlikely that parties that intentionally cover-up an offense to render it ambiguous would also report the matter to the SEC (unless unanticipated events intervene). Thus, for insiders, apparency may instead be negatively related to their referral of matters to the Commission. For most of these tables, attention is centered on the behavior of investors, for whom many of these confounding factors are absent.

Table 6.10 presents data on detection and offense apparency, reflected in stock manipulation and self-dealing. Offenses of this kind tend not to be very apparent, in part because they can be enacted without any contact with victims of an embodied or disembodied sort and without any involvement of victims, in part because the profits that accrue to the offenders may not involve a commensurate loss to other parties. Stock manipulations may involve faceless

TABLE 6.10: DETECTION AND OFFENSE APPARENCY - MANIPULATION, SELF-DEALING

% DOWN	NO MANIPULATION, SELF-DEALING		MANIPULATION, SELF-DEALING		TOTAL CASES	
(1) Surveillance	34	9%	21	32%	55	12%
(2) Incursions	146	39%	21	32%	167	38%
(3) Insiders	35	9%	4	6%	39	9%
(4) Investors	114	30%	12	18%	126	29%
(5) Securities Community	38	10%	12	18%	50	11%
(6) Other Social Control Agencies	112	30%	18	27%	130	30%
(1) Market Surveillance	4	1%	18	28%	22	5%
(1) Other Surveillance	30	8%	4	6%	34	8%
(2) Inspections	34	9%	3	5%	37	8%
(2) Filings	88	24%	8	12%	96	22%
(2) Spin-offs	29	8%	12	18%	41	9%
(3) Participating Insiders	14	4%	1	2%	15	3%
(3) Self-Disclosures	18	5%	3	5%	21	5%
(3) Employers	4	1%	0	0%	4	1%
(4) Actual Investors	95	26%	10	15%	105	24%
(4) Solicited Investors	29	8%	3	5%	32	7%
(5) Informants	14	4%	8	12%	22	5%
(5) Professionals	24	6%	4	6%	28	6%
(6) Federal Agencies	19	5%	6	9%	25	6%
(6) State Agencies	53	14%	6	9%	59	14%
(6) Self-Regulatory Agencies	41	11%	6	9%	47	11%
TOTAL	374		66		440	
More Than One Source	103	28%	26	40%	129	30%
Different Sources	75	20%	19	29%	94	22%

transactions in the market place, self-dealing, private transactions identical in form and content to fully licit transactions.

As the table indicates, few strategies seem particularly well suited for the detection of offenses of this kind, which comprise 15% of the cases. However, as expected, that group least likely to refer offenses of this kind is composed of investors: They detect 30% of other offenses, but only 18% of those involving manipulation or self-dealing, and this difference is even 6% greater for only those cases in which victims were generated. Although perhaps other factors account for this finding, it is clearly plausible that investors refer less frequently despite victimization because these offenses are often simply too invisible for them to be aware of.

Of course, the big source of offenses involving manipulation or self-dealing is that of market surveillance. An investigation instituted on the basis of market surveillance is twenty-eight times more likely to involve manipulation and self-dealing (28%) than other offenses (1%). Although SEC investigators are perhaps better suited to uncover complex and subtle offenses, this does not account for the huge disparity between this strategy and that of investor referrals. For, like investors, other SEC surveillance strategies and proactive measures are also unlikely to detect offenses of this kind. As discussed more fully in Chapter 5, market surveillance is a deliberate and sophisticated technology designed to look for stock trading patterns indicative of manipulation and insider trading (a major component of self-dealing). Indeed, there is little else with regard to illegality that can be inferred from surveillance data, reflected in the fact that 82% of all investigations arising from this source pertain to allegations of manipulation or self-dealing.

The other major ways in which offenses of this kind are caught are through spin-offs (18% vs. 8%) and informants (12% vs. 4%). Both of these findings are

consistent with the assumption that one needs to have considerable access to illegality with considerable information and observational opportunities to make inferences about subtle, nonapparent kinds of illegality. Spin-offs are based on the extraordinary data opportunities available from previous investigations. Informants presumably know of the illegality and lack the disincentives to report it, characteristic of true insiders, the only other group for which apparency is irrelevant.

At the opposite pole of an "apparency" continuum on which manipulation and self-dealing are located are offenses involving misappropriation.[10] Many embezzlements and misappropriations are ultimately apparent because they constitute a direct loss to victims, the explanation for which is often rather clear. Indeed, perhaps the most important difference between self-dealing and embezzlement, generically both kinds of misappropriation, is that self-dealing is couched in routinely licit transactions and embezzlement is not, and therefore the former is much more difficult to detect than the latter. Because offenses of this kind are more likely to be more apparent, one would expect investors to be a more significant source of these cases than those pertaining to manipulation or self-dealing.

Table 6.11 displays the relationship between detection and misappropriation. Offenses involving misappropriation have been differentiated by apparency as well, with the less apparent or subtle offenses reflecting actions that may not clearly involve the theft of money, for example, churning, charging unfair prices, use of customer stock for collateral on personal loans, etc. The data clearly confirm the hypothesis about investor behavior. Actual investors are considerably more likely to report offenses involving blatant

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[10] See Chapter 4 for a detailed discussion of the forms of misappropriation found in the securities context.

TABLE 6.11: DETECTION AND OFFENSE APPARENCY - MISAPPROPRIATION

% DOWN	NO MISAPPROP-RIATION	SUBTLE MISAPPROP-RIATION ONLY	BLATANT MISAPPROP-RIATION	TOTAL CASES
(1) Surveillance	43 13%	4 14%	8 9%	55 12%
(2) Incursions	129 40%	11 39%	27 30%	167 38%
(3) Insiders	23 7%	3 11%	13 14%	39 9%
(4) Investors	70 22%	5 18%	51 57%	126 29%
(5) Securities Community	34 11%	3 11%	13 14%	50 11%
(6) Other Social Control Agencies	90 28%	12 43%	28 31%	130 30%
(1) Market Surveillance	19 6%	3 11%	0 0%	22 5%
(1) Other Surveillance	25 8%	1 4%	8 9%	34 8%
(2) Inspections	20 6%	5 18%	12 14%	37 8%
(2) Filings	84 26%	5 18%	7 8%	96 22%
(2) Spin-offs	28 9%	3 11%	10 11%	41 9%
(3) Participating Insiders	6 2%	1 4%	8 9%	15 3%
(3) Self-Disclosures	17 5%	2 7%	2 2%	21 5%
(3) Employers	0 0%	0 0%	4 4%	4 1%
(4) Actual Investors	53 17%	4 14%	48 54%	105 24%
(4) Solicited Investors	23 7%	2 7%	7 8%	32 7%
(5) Informants	16 5%	2 7%	4 4%	22 5%
(5) Professionals	18 6%	1 4%	9 10%	28 6%
(6) Federal Agencies	17 5%	3 11%	5 6%	25 6%
(6) State Agencies	37 12%	6 21%	16 18%	59 14%
(6) Self-Regulatory Agencies	35 11%	3 11%	9 10%	47 11%
TOTAL	322	28	90	440
More Than One Source	79 25%	13 46%	37 42%	129 30%
Different Sources	50 16%	9 32%	35 39%	94 22%

misappropriations (54% of them) than those not involving misappropriation (17% of them). The relationship remains substantially the same, though a bit stronger when victimization is controlled. The data, however, also suggest that it is not misappropriation per se that is reported by investors, but only its apparent, blatant manifestations. Investors are even less likely to complain about subtle forms of misappropriation - churning, etc. - than about other offenses, presumably because in the former case, they are unaware of their victimization. The finding of high rates of reporting blatant misappropriations does not hold for solicited investors. They have been solicited, but transactions have not been completed and money transmitted which offenders can misappropriate. Hence there is nothing to report.

The only major proactive detection strategy that uncovers misappropriation is the SEC inspection. While it detects 6% of those offenses which do not involve misappropriation, it uncovers 15% of those offenses which do. Inspections are especially likely to uncover the less apparent forms of misappropriation (18%) that elude investors. Their success is derived from the fact that inspections permit close scrutiny of the books and records of broker-dealers. Although an extensive cover-up may conceal misappropriations from these records, it is often possible to deduce patterns of churning, improper hypothecation of client securities, failure to deliver securities, etc. from books and records, receipts, records of securities transactions and the like, which are examined during broker-dealer inspections. Inspections are considerably less successful, however, in detecting misappropriations by parties that cannot be directly inspected such as stock issuers. Indeed, not a single case of blatant or subtle misappropriation was uncovered by inspections unless a broker-dealer was one of the offenders.

Misappropriation is one of the few forms of offense that insiders seem

willing to report. As indicated in Table 6.11, 60% of all reports by participating insiders and 100% of those by employers allege misappropriation. These tend to be offenses in which the misappropriation is localized, reflecting the conduct of a single person or only a portion of the offenders in a larger scheme. The employers are principals of broker-dealer firms reporting on embezzlement of firm funds or those of its clients by an employee. Participating insiders typically are not among the insiders deriving misappropriated funds. They refer cases to the SEC, then, because they are not engaged in self-reporting in this instance; indeed they may have been victimized themselves. When employers and all insiders share equally in illegal conduct, the incidence of reporting to the SEC is considerably lower, as presumably are the incentives.

As Chapter 4 indicated, about two-thirds of all investigations in the sample pertain to offenses for which there are allegations of misrepresentation. As a class, misrepresentations tend not to be very apparent. Misrepresentations apply to statements inherent in both licit and illicit securities transactions, and indeed are often identical to licit representations. What differs is the factual situation they allegedly describe. Perhaps the most distinctive characteristic of investments as a form of economic exchange is that shareholders do not own a tangible commodity which they can possess or examine. They own a share of an organization that others manage. They are not permitted the kind of scrutiny of the organization available, for example, to the potential purchaser of a consumer good. (Nor would they know what to scrutinize even if permitted this access). Further complicating the problem, is the fact that investments are premised on a concern for future performance and return, which further aggravates the informational imbalance confronted by the potential investor. For all of these reasons, the investor's spatial, technological, and

temporal distance from information necessary to evaluate investment opportunities or to test the information provided for this purpose, it is no wonder that misrepresentations go easily undetected.

In other words, misrepresentations are typically not apparent, and this quality therefore poses problems of detection. We would expect that the most vulnerable victim of subtlety, the investor, would therefore contribute less than his share of offenses of this kind through referral. This is not the case: Investor complaints comprise 29% of the sample, but reflect 35% of all offenses alleging misrepresentation. The reason, of course, is the high correlation, noted in Chapter 4, between misrepresentation and other offenses. When offenses involving misrepresentation as well as apparent violatons like blatant misappropriation are differentiated from those which do not, the result is dramatic. As noted in Table 6.12, investors refer a quarter of the less apparent misrepresentation cases and three-fifths of those coupled with other blatant offenses. The relationship is slightly higher for actual investors only and the same when victimization is controlled.

As Table 6.12 indicates, few detection strategies are exceptionally well suited for uncovering straight misrepresentations, but investors remain exceptionally unsuited for this task. Many of the other correlations in the table, for example, involving market surveillance or participating insiders, simply reflect the other offense subtlety tables. Misrepresentations per se, then, are not easily detected. The likelihood that they will be detected and the means of detection is dependent upon other elements of illegality associated with misrepresentations.

In summary, the apparency of an offense plays a significant role in its detection, particularly for victimized investors. Table 6.13 summarizes this role. A single indicator of the degree of apparency has been created. It is

TABLE 6.12: DETECTION AND OFFENSE APPARENCY - EXCLUSIVITY OF MISREPRESENTATIONS

% DOWN	MORE SUBTLE MISREPRESEN-TATIONS		MISREPRESEN-TATIONS COUPLED WITH MORE BLATANT OFFENSES		TOTAL CASES	
(1) Surveillance	37	18%	7	10%	44	16%
(2) Incursions	70	33%	23	34%	93	33%
(3) Insiders	17	8%	9	13%	26	9%
(4) Investors	56	26%	41	60%	97	35%
(5) Securities Community	29	14%	8	12%	37	13%
(6) Other Social Control Agencies	71	34%	21	31%	92	33%
(1) Market Surveillance	15	7%	0	0%	15	5%
(1) Other Surveillance	22	10%	8	12%	30	11%
(2) Inspections	16	8%	9	13%	25	9%
(2) Filings	36	17%	7	10%	43	15%
(2) Spin-offs	21	10%	9	13%	30	11%
(3) Participating Insiders	7	3%	6	9%	13	5%
(3) Self-Disclosures	10	5%	2	3%	12	4%
(3) Employers	0	0%	2	3%	2	1%
(4) Actual Investors	43	20%	40	59%	83	30%
(4) Solicited Investors	20	10%	5	7%	25	9%
(5) Informants	12	6%	3	4%	15	5%
(5) Professionals	17	8%	5	7%	22	8%
(6) Federal Agencies	17	8%	5	7%	22	8%
(6) State Agencies	33	16%	12	18%	45	16%
(6) Self-Regulatory Agencies	21	10%	6	9%	27	10%
TOTAL	212		68		280	
More Than One Source	72	34%	31	46%	103	37%
Different Sources	51	24%	29	43%	80	29%

TABLE 6.13: DETECTION AND OVERALL OFFENSE APPARENCY

% DOWN	NOT AT ALL APPARENT		NEITHER		APPARENT		TOTAL CASES	
(1) Surveillance	20	20%	7	5%	28	13%	55	12%
(2) Incursions	44	44%	66	51%	57	27%	167	38%
(3) Insiders	10	10%	6	5%	23	11%	39	9%
(4) Investors	15	15%	19	15%	92	44%	126	29%
(5) Securities Community	17	17%	3	2%	30	14%	50	11%
(6) Other Social Control Agencies	27	27%	33	26%	70	33%	130	30%
(1) Market Surveillance	11	11%	1	1%	10	5%	22	5%
(1) Other Surveillance	10	10%	6	5%	18	9%	34	8%
(2) Inspections	9	9%	5	4%	23	11%	37	8%
(2) Filings	25	25%	55	43%	16	8%	96	22%
(2) Spin-offs	13	13%	7	6%	21	10%	41	9%
(3) Participating Insiders	2	2%	0	0%	13	6%	15	3%
(3) Self-Disclosures	8	8%	6	5%	7	3%	21	5%
(3) Employers	0	0%	0	0%	4	2%	4	1%
(4) Actual Investors	11	11%	13	10%	81	39%	105	24%
(4) Solicited Investors	7	7%	6	5%	19	9%	32	7%
(5) Informants	9	9%	2	2%	11	5%	22	5%
(5) Professionals	8	8%	1	1%	19	9%	28	6%
(6) Federal Agencies	10	10%	2	2%	13	6%	25	6%
(6) State Agencies	9	9%	12	9%	38	18%	59	14%
(6) Self-Regulatory Agencies	7	7%	19	15%	21	10%	47	11%
TOTAL	100		129		211		440	
More Than One Source	33	33%	15	12%	81	39%	129	30%
Different Sources	26	26%	4	3%	64	31%	94	22%

based on the differences in offense type introduced above. The indicator is also sensitive, however, to the contribution that the way in which any given offense is executed makes to overall apparency. Three attributes of offense execution, the use of high pressure promotional techniques and embodied communications, on the apparent side, and the attempt to cover up transactions, on the less apparent side, are included in the overall indicator. Because of the quality of the data available, these variables in themselves do not discriminate offenses in the sample with respect to apparency. But they do add some richness to an indicator already based upon offense-related discriminations. The indicator has three categories, distinguishing between offenses that are quite apparent, that are not at all apparent, and that are intermediate between these two categories. Cases are assigned to the "apparent" category if they involve blatant misappropriations, embodied communications, or high pressure promotional techniques. Cases not classified in this first category are assigned to the "not at all apparent" category, if illegal activity involved subtle misappropriations, misrepresentations, stock manipulation, self-dealing, or cover-up. Twenty-three percent of the cases in the sample are classified as not at all apparent, half as apparent. Twenty-nine percent of the cases, many of which involve technical kinds of violations, fall in neither category.

As indicated in Table 6.13, proactive detection strategies - surveillance and incursions - are more likely to uncover subtle than apparent violations (20% versus 13%, 44% versus 27%, respectively). These differences are due primarily to the categories of market surveillance and filings, however. On the other hand, most reactive detection strategies overall, save referrals by securities professionals, are more likely to uncover apparent than subtle offenses. However, the significant finding in this category pertains to actual investors

(77% of whom report only apparent offenses), who contribute 11% of those offenses that are subtle and 39% of those that are apparent. So many of the patterns in the table are idiosyncratic to the nature of a detection strategy that they are difficult to interpret. The investor finding is not one of them, nor, most likely, is the finding that informants are almost twice as likely to refer subtle matters as apparent ones (9% vs.5%), presumably because they have access to inside information and lack the disincentives to self-reporting characteristic of insiders.

The bottom two rows of Tables 6.10 through 6.13 displayed the relationship of offense apparency to multiple detection. The patterns across these tables were perplexing and inconsistent. Where the offenses of stock manipulation or self-dealing (Table 6.10) are indicators of apparency, we learn that subtlety increases the likelihood of multiple detection. Offenses with elements of manipulation or self-dealing are about 10% more likely to be detected more than once and by different methods than offenses without these elements. A finding that rendering an offense less apparent increases the likelihood of multiple detection, if true, is terribly significant. However, the data in Tables 6.11 and 6.12 disconfirm this finding. Where indicators of apparency involve the role of misappropriation and misrepresentation, we learn that, as one might expect, subtlety decreases the likelihood of multiple detection - by slightly larger percentages.

Table 6.13 provides a final insight concerning the relationship of offense apparency to the likelihood that it will be detected more than once and by different methods. As indicated in the bottom two rows of the table, both apparent and not at all apparent offenses are substantially more likely to experience multiple detection than other offenses, though multiple and different sources are about 5% more likely to be found with apparent than with not at all

apparent offenses. These neither apparent nor not at all apparent offenses are predominantly technical violations, a form of offense most unlikely to be detected more than once. Although subtlety does preclude the possibility of multiple detection slightly, the vulnerability of offenses to multiple detection derives from some other characteristic of the offense.

The matter of offense subtlety also helps to sort out some of the confusing findings presented earlier in the chapter with regard to the extent and cost of victimization and their correlation to rates of investor complaint. It had been hypothesized that investor reporting behavior should be positively correlated with increasing numbers of victims and increasing costs of victimization. These hypotheses were largely disconfirmed. However, apparency is systematically related to these victimization phenomena. If we inquire only about the apparent offenses, about which investors are more likely to be witting, the hypotheses are supported. For these offenses, the proportion of investigations instituted as a result of investor complaints increases fairly linearly from 44% of the offenses with less than twenty-six victims to 67% for those with more than 500; and from 33%, where less than $5,001 overall was involved to 60%, where more than $1,000,000 was. The data also indicate that a higher proportion of the offenses between previous acquaintances than between strangers are apparent (86% versus 76%, respectively). This perhaps explains the anomalous finding, cited earlier in the chapter, that investors are more likely to report on the conduct of acquaintances than that of strangers.

So investors do not complain despite victimization because the offenses victimizing them are not apparent. The implicit argument, then, is that where victims are unwitting, they do not complain. However, an alternative explanation can be applied to these findings. Victims are rarely unwitting; even for subtle violations, they are aware of the illegal activities. Rather,

what differentiates apparent and not at all apparent offenses is the investors' sense of their victimization. They may not perceive themselves as victims in the same way when the officers of a corporation in which they are shareholders are engaged in self-dealing as when their stock broker embezzles their personal funds. These examples are different in two respects: the extent to which the investor is directly involved in the offense as well as the clarity of theft implicit in the conduct. One of the interesting issues in the contrast between white collar and street crime is the difference in public attitudes about the moral reprehensibility of the different offenses.[11] Not apparent offenses may be less reprehensible to victims, and victims may, therefore, be less likely to complain. This argument, of course, is highly speculative. Most likely both explanations of the relationship of offense apparency and investor reporting behavior have some validity. Some non-reporting exists because victims are truly unwitting; some because victims do not feel directly victimized or feel any outrage by the offenses that touch them. These are empirical questions; unfortunately data that bear on them are unavailable from any source.

Conclusion

In this chapter, some of the ideas developed in Chapter 1 - that characteristics of an offense account for the way in which it is detected - have been applied to the data on securities violations and SEC intelligence activities. The most adequate indicators of the organization and vulnerabilities of securities violations, found in the dataset, pertain to the embodied or disembodied media employed in the execution of an offense, offender constellations, prior relationships of offenders to the SEC, patterns of victimization, and offense apparency. These indicators are but a subset, and in fact a somewhat superficial subset, of the set of variables that pertain to the

[11] For a review of this issue, see Shapiro 1980.

organization and vulnerabilities of white collar offenses. But they help in beginning to sensitize ourselves to the kind of theory of the relationship between intelligence and illegality that must be developed.

The most interesting findings in the chapter pertain to the contrast between investor complaints and proactive detection methods, particularly surveillance, with respect to offense characteristics. Investors have to be practically hit over the head with information before they will communicate with the SEC. In general, their investments must be the result of embodied communications or transactions, often in response to high pressure tactics. If they are victimized, even in substantial numbers and by substantial amounts of money, they are unlikely to complain unless the offense was clearly apparent. If offenders can render victims unwitting, then, they can protect themselves from investor disclosures. In contrast, surveillance strategies are not restricted by the apparency of offenses. They are able to penetrate the subtleties of offenses and detect those which are not at all apparent. And they are more likely to detect offenses utilizing disembodied than embodied media of transaction or communication, presumably larger scale offenses.

In short, the offenses reported by investors tend to be blatant, small-scale victimizations; those detected by surveillance tend to be more subtle and more large-scale. Like surveillance, incursions and referrals from the securities community tend to uncover less apparent offenses; like investors, other reactive investigative sources are more sensitive to apparent offenses. For neither group, however, is the embodiment of offense transactions related to detection opportunities.

Two other significant findings emerge from this chapter. First, despite theoretical statements to the contrary, the relationship between the number and constellation of offenders to intelligence is not dramatic, although this may

derive from the grossness of the indicators rather than the quality of the theoretical ideas. However, the data do support the predicted notion that, as the scope of offending increases intra-organizationally, the likelihood of insider disclosures increases; as the scope of offending increases inter-organizationally, the extent of detection by surveillance and by referrals from the securities community increases.

Finally, analysis of the relationship between detection and prior offender relationships to the SEC reveals a rather dramatic finding. Proactive detection methods, although they do uncover some law violations by SEC registrants, are most insensitive to the activities of non-registrants. If the agency seeks to mount an enforcement program against the offenses of non-registrants, they are almost entirely dependent on reactive strategies to uncover these offenses, as SEC intelligence is presently organized.

From the data presented in this chapter, we can begin to make inferences about the way in which different detection strategies net very different kinds of offenses. Now we address this issue head-on, by reversing the analytic structure and recasting detection strategies from dependent to independent variables and offense characteristics from independent to dependent variables. We inquire about the effect of detection strategy on the composition of offenses so caught. We "evaluate the catch."

CHAPTER 7: EVALUATING THE CATCH: THE CONSEQUENCES OF DETECTION STRATEGY

In the previous chapter, characteristics of the nature, organization, or execution of illegal activity and their impact on the detection of this activity were considered. Whether for these reasons, or others which the research failed to measure or the analysis neglected to consider, it is expected that detection methods differ in the offenses that they typically uncover. In this chapter, detection methods are contrasted with respect to the nature of the offenses and offenders that they supply to the investigative process and with respect to the quality of offenses uncovered - their scope, magnitude, impact, duration, and significance.

Aside from the theoretical interest generated by the kind of analylsis developed in Chapter 6, the true test of the value of the study of detection strategy is its impact on the determination of the composition of investigative caseload. For surely if detection strategies bear no relationship to characteristics of offenses and offenders, if each is like a random sampling strategy which draws indistinguishable samples from a population of illegalities, then this analysis is misguided. Instead, it should focus on the most efficient or least costly of these detection strategies.

Of course, this is not the case. If resources were reallocated or priorities altered to emphasize or deemphasize a particular kind of detection, investigative caseload would look rather different in terms of what is investigated, who is investigated, when it is investigated, and how it is investigated.

Differences in Offense Composition

Much has been said in this dissertation about the nature of securities violations. A major portion of Chapter 4 was devoted to the development of a

statistical and ethnographic portrait of the generic elements of securities violations and to a consideration of the typical constellations of these elements in a given offense. Chapter 2, concerned with research methods, grappled without much success with the problem of how one delimits a host of activities - differentially shared by numerous participants reflecting disparate roles, extending over time and across geographic space - as one or more offenses or cases. Although enumerating kinds of activities or generic elements, any one of which may constitute a securities violation, may be rather straightforward, distinguishing between and differentiating constellations of activities is considerably less so. In short, the operational definition and conceptualization of a securities violation is terribly complex.

This complexity enters into an analysis of the relationship between detection method and violation. As described in Chapter 4, on the average, cases in the sample involve the investigation of over five different elements of illegality, for example, a case involving technical and registration violations, misapproporiation, self-dealing and several misrepresentations. So, on the one hand, one can attempt to explain the detection of over 2,800 discrete violations. Or, on the other hand, one can argue that these 5+ violations comprised a single offense involving self-dealing and misappropriation which was executed and covered-up by activities violating technical and registration requirements and involving the use of misrepresentations. In the latter case, one would attempt to explain the detection of 526 composite offenses.

Each perspective, based upon discrete violations or upon offense constellations, provides a different insight into the relationship of detection and characteristics of illegality. The former perspective reflects the fact that one need not detect an entire offense constellation, but only some aspect of it, after which investigative work can uncover all elements of the illegal

activity. It is a significant question to ask, then, whether there are patterns in case detection based on any one element of the offense. Take the example of the case of misappropriation and self-dealing with ancillary registration and technical violations and misrepresentations. And take an entirely different offense, simply involving failure to file annual reports with the SEC, the technical violation in the first offense as well. It is entirely likely that both offenses were detected in the same way - through incursions based on filings. Hence, the common element of the two offenses - technical violations - is related to the method by which they were detected. This is the vantage point of an analysis of discrete violations. It examines whether detection strategies vary in the likelihood that they will uncover a particular kind of violation and whether particular elements of an offense are typically detected through a particular method.

The latter perspective, based upon an analysis of offense constellations, focuses on more policy relevant issues of this analysis. The two examples cited above reflect extremely different offenses, their differences obscured when each of their generic elements is contrasted separately. Here we ask whether there are differences across detection methods in the actual offenses that are uncovered. How likely is it that misappropriation/self-dealing offenses will be detected if the system relied solely on the examination and follow-up of filings? From this perspective, we examine whether detection strategies vary in the kind of offenses they uncover and whether particular offenses are typically detected through a particular strategy.

Since offense elements and constellations are correlated, the two lines of analysis converge at many points. Neither perspective - on offense elements or constellations - is inherently more powerful or significant than the other. In this chapter, analysis will pertain to constellations, simply because they

comprise a smaller group, are easier to grasp, and are more policy relevant. For those readers with greater interest in the generic elements of offense than their aggregation in constellations, Table 7.1 presents the relationship of detection strategy to offense elements.

Offense Constellations

The categories salient to a perspective on the generic elements of illegality are already familiar to the reader. They were employed in organizing the ethnographic descriptions of kinds of securities violations presented in Chapter 4. The offense constellation variable is new to the analysis, however. This variable is based on an examination of the generic elements of illegality. Offense categories are assigned according to the following formula. Offenses that involve self-dealing or stock manipulation (N=86) are so classified, regardless of other elements included in the violation. Those that involve elements of misappropriation, registration violation, and misrepresentation, basically investment schemes (N=58), are so classified. Offenses involving misappropriation without both registration violations and misrepresentations, offenses closer to embezzlement or simply misappropriation (N=39), are classified as misappropriations. Offenses with both registration violations and misrepresentations (N=80) are so classified. The final three categories reflect the simplest forms of offense: misrepresentations alone (N=42), registration violations alone (N=48), and technical violations alone (N=84). Technical violations may be elements of offenses in any of the other categories. They are ignored unless they reflect the only element of violative conduct.

The logic underlying the classificatory scheme is based on a conception of a hierarchy of forms of illegality, the lower levels of which are considered means of cover-up or ancillary violations when accompanying those higher in the hierarchy. There are distinctions that are lost by this scheme that may be

TABLE 7.1: DETECTION AND ELEMENTS OF OFFENSE

% ACROSS.	(1) Stock Manipulation		(2) Misappropriations		(3) Self-Dealing		(4) Investment Schemes		(5) Misrepresentations About Corporation		(6) Misrepresentations About Security		(7) Misrepresentations About Investment Advice		(8) Any Misrepresentation	
(1) Surveillance	18	33%	14	26%	20	36%	4	7%	37	67%	33	60%	4	7%	45	82%
(2) Incursions	14	8%	40	24%	20	12%	9	5%	78	47%	65	39%	2	1%	93	56%
(3) Insiders	4	10%	17	44%	6	15%	4	10%	25	64%	15	38%	1	3%	26	67%
(4) Investors	8	6%	60	48%	19	15%	4	3%	81	65%	82	66%	1	1%	99	79%
(5) Securities Community	9	18%	18	37%	9	18%	8	16%	31	63%	31	63%	1	2%	40	82%
(6) Other Social Control Agencies	12	9%	41	32%	14	11%	11	8%	82	63%	72	55%	2	2%	97	75%
(1) Market Surveillance	12	68%	4	18%	13	59%	2	9%	12	54%	9	41%	2	9%	16	73%
(1) Other Surveillance	3	9%	10	29%	8	22%	2	6%	26	76%	24	71%	2	6%	30	88%
(2) Inspections	2	5%	17	46%	6	16%	1	3%	18	49%	18	49%	0	0%	25	68%
(2) Filings	7	7%	13	14%	8	8%	3	3%	37	38%	29	30%	1	1%	43	45%
(2) Spin-offs	7	18%	14	35%	10	25%	7	18%	28	70%	22	55%	1	2%	30	75%
(3) Participating Insiders	1	7%	9	60%	2	13%	0	0%	12	80%	9	60%	0	0%	13	87%
(3) Self-Disclosures	2	10%	5	24%	3	14%	4	19%	12	57%	6	29%	1	5%	12	57%
(3) Employers	1	25%	4	100%	1	25%	0	0%	2	50%	1	25%	0	0%	2	50%
(4) Actual Investors	7	7%	56	54%	17	16%	3	3%	69	66%	73	70%	1	1%	83	80%
(4) Solicited Investors	2	6%	9	28%	2	6%	1	3%	22	69%	20	62%	1	3%	27	84%
(5) Informants	6	27%	7	32%	5	23%	4	18%	13	59%	11	50%	1	4%	15	68%
(5) Professionals	3	11%	11	41%	4	15%	4	15%	18	67%	20	74%	0	0%	25	93%
(6) Federal Agencies	3	12%	9	36%	4	16%	4	16%	22	88%	17	68%	0	0%	22	88%
(6) State Agencies	6	10%	22	37%	7	12%	5	8%	38	64%	39	66%	1	2%	48	81%
(6) Self-Regulatory Agencies	4	8%	12	26%	3	6%	2	4%	25	53%	19	40%	1	2%	29	62%
TOTAL	43	10%	127	29%	58	13%	31	7%	237	54%	212	48%	10	2%	288	66%
More Than One Source	21	16%	53	41%	31	24%	9	7%	91	70%	80	62%	1	1%	105	81%
Different Sources	19	20%	46	49%	23	24%	7	7%	69	73%	61	65%	1	1%	82	87%

Continued

TABLE 7.1: DETECTION AND ELEMENTS OF OFFENSE, continued

% ACROSS	(9) Registration Violations-Security	(10) Registration Violations-Professional	(11) Technical Violations-Issuers	(12) Technical Violations-Broker-Dealers	(13) Broker-Dealer Sales Techniques	(14) Boiler Rooms	(15) Previous Social Control	(16) TOTAL
(1) Surveillance	32 58%	8 14%	2 4%	3 6%	3 6%	3 6%	4 7%	55
(2) Incursions	54 32%	12 7%	19 11%	78 47%	24 14%	10 6%	49 30%	166
(3) Insiders	17 44%	2 5%	8 20%	10 26%	9 23%	2 5%	3 8%	39
(4) Investors	78 62%	12 10%	12 10%	25 20%	12 10%	8 6%	6 5%	125
(5) Securities Community	30 61%	5 10%	5 10%	9 18%	5 10%	5 10%	6 12%	49
(6) Other Social Control Agencies	77 59%	13 10%	7 5%	24 18%	14 11%	7 5%	11 8%	130
(1) Market Surveillance	9 41%	1 4%	1 4%	0 0%	1 4%	2 9%	2 9%	22
(1) Other Surveillance	23 68%	7 21%	1 3%	3 9%	2 6%	1 3%	2 6%	34
(2) Inspections	12 32%	4 11%	8 22%	33 89%	10 27%	3 8%	8 22%	37
(2) Filings	20 21%	4 4%	12 12%	43 45%	10 10%	4 4%	35 36%	96
(2) Spin-offs	24 60%	5 12%	1 2%	7 18%	5 12%	3 8%	8 20%	40
(3) Participating Insiders	9 60%	1 7%	3 20%	1 7%	2 13%	2 13%	1 7%	15
(3) Self-Disclosures	8 38%	1 5%	5 24%	9 43%	5 24%	0 0%	1 5%	21
(3) Employers	1 25%	0 0%	0 0%	0 0%	2 50%	0 0%	1 25%	4
(4) Actual Investors	63 61%	9 9%	9 9%	21 20%	10 10%	5 5%	5 5%	104
(4) Solicited Investors	23 72%	4 12%	5 16%	6 19%	2 6%	4 12%	2 6%	32
(5) Informants	9 41%	1 4%	3 14%	6 27%	2 9%	2 9%	1 4%	22
(5) Professionals	21 78%	4 15%	2 7%	3 11%	3 11%	3 11%	5 18%	27
(6) Federal Agencies	17 68%	2 8%	2 8%	2 8%	2 8%	2 8%	3 12%	25
(6) State Agencies	41 70%	9 15%	2 3%	5 8%	2 3%	2 3%	3 5%	59
(6) Self-Regulatory Agencies	23 49%	3 6%	3 6%	13 28%	9 19%	2 4%	5 11%	47
TOTAL	217 50%	34 8%	35 8%	111 25%	53 12%	22 5%	64 15%	437
More Than One Source	74 57%	14 11%	18 14%	33 26%	15 12%	1 9%	17 13%	129
Different Sources	54 57%	11 12%	14 15%	27 29%	12 13%	10 11%	12 13%	94

rather meaningful. However, given the small sample size, it is impossible to make any additional distinctions.

The assignment to categories of this offense constellation variable is based, not on a content analysis of the complex structure of illegal activities per case, but rather on computer analysis of the generic elements of illegality reflected in these activities. These generic elements were originally assigned as a result of an earlier content analysis of longhand descriptions of all offenses in the sample. Because ultimate assignment to the offense constellation variable was not based on a second content analysis, it is possible but unlikely that some offenses may be misclassified.

The relationship between detection strategy and illegality is indeed quite strong. Table 7.2 displays this relationship for the offense constellations described earlier. Percentages are computed across the rows. Were there no relationship, percentage differences within each of the columns, reflecting different offenses, would be minimal. As the table clearly demonstrates, this is not the case; for many of the offense categories, differences are in excess of thirty percent.

The row labeled "TOTAL" near the bottom of the page displays the distribution of offenses for the sample as a whole. When it is contrasted with other rows on the table, one gets some sense for how different this sample of illegalities would look if only a particular detection strategy were in operation. In the extreme case, note the market surveillance row: with the exception of 4% of the offenses involving misrepresentations, the remaining 95% of the offenses caught involve self-dealing or stock manipulation. An enforcement population so constructed would have no offenses involving technical or registration violations, combinations of non-registration and misrepresentation, misappropriations, or investment schemes (non-registration,

TABLE 7.2: DETECTION AND OFFENSE CONSTELLATIONS

% ACROSS	None		Technical Violations Only		Registration Violations Only		Misrepresentations Only		Registration Violations and Misrepresentations		Misappropriations Only		Registration Violations, Misrepresentations, and Misappropriations		Manipulation, Self-Dealing		TOTAL
(1) Surveillance	0	0%	0	0%	4	7%	4	7%	13	24%	0	0%	5	9%	29	53%	55
(2) Incursions	1	1%	65	39%	9	5%	15	9%	19	11%	13	8%	15	9%	30	18%	167
(3) Insiders	0	0%	5	13%	4	10%	5	13%	5	13%	6	15%	8	20%	6	15%	39
(4) Investors	1	1%	2	2%	15	12%	11	9%	26	21%	19	15%	28	22%	24	19%	126
(5) Securities Community	1	2%	3	6%	2	4%	2	4%	13	26%	3	6%	9	18%	17	34%	50
(6) Other Social Control Agencies	0	0%	15	12%	16	12%	13	10%	30	23%	12	9%	21	16%	23	18%	130
(1) Market Surveillance	0	0%	0	0%	0	0%	1	4%	0	0%	0	0%	0	0%	21	95%	22
(1) Other Surveillance	0	0%	0	0%	4	12%	3	9%	13	38%	0	0%	5	15%	9	26%	34
(2) Inspections	0	0%	8	22%	1	3%	2	5%	6	16%	8	22%	4	11%	8	22%	37
(2) Filings	0	0%	55	57%	2	2%	11	12%	8	8%	1	1%	6	6%	13	14%	96
(2) Spin-offs	1	2%	3	7%	6	15%	2	5%	5	12%	4	10%	6	15%	14	34%	41
(3) Participating Insiders	0	0%	0	0%	0	0%	2	13%	3	20%	3	20%	5	33%	2	13%	15
(3) Self-Disclosures	0	0%	5	24%	4	19%	3	14%	2	10%	1	5%	3	14%	3	14%	21
(3) Employers	0	0%	0	0%	0	0%	0	0%	0	0%	2	50%	1	25%	1	25%	4
(4) Actual Investors	1	1%	1	1%	10	10%	9	9%	19	18%	17	16%	26	25%	22	21%	105
(4) Solicited Investors	0	0%	1	3%	5	16%	4	12%	10	31%	2	6%	7	22%	3	9%	32
(5) Informants	0	0%	2	9%	2	9%	1	4%	2	9%	3	14%	2	9%	10	45%	22
(5) Professionals	1	4%	1	4%	0	0%	1	4%	11	39%	0	0%	7	25%	7	25%	28
(6) Federal Agencies	0	0%	0	0%	3	12%	4	16%	4	16%	1	4%	7	28%	6	24%	25
(6) State Agencies	0	0%	0	0%	8	14%	6	10%	18	30%	4	7%	11	19%	12	20%	59
(6) Self-Regulatory Agencies	0	0%	13	28%	6	13%	4	8%	7	15%	5	11%	7	15%	6	13%	47
TOTAL	3	1%	84	19%	48	11%	42	10%	80	18%	39	9%	58	13%	86	20%	440
More Than One Source	0	0%	6	5%	11	8%	12	9%	22	17%	12	9%	22	17%	44	34%	129
Different Sources	0	0%	4	4%	2	2%	7	7%	16	17%	11	12%	20	21%	34	36%	94

misrepresentation, misappropriation), in contrast to the present sample, 70% of which involve these very offenses. At the opposite extreme, note the row in the top portion of the table reflecting referrals from other social control agencies. This category, which aggregates state, federal, and self-regulatory agencies, is remarkably similar in offense composition to the total sample.[1] Proportions in offense categories are within three percent of each other for each offense except technical violations which are slightly more common in the total sample (19% vs. 12%) and non-registration coupled with misrepresentation offenses which comprise a slightly lower proportion of the total sample (18% vs. 23%).

Most other sources of investigation fall somewhere between these extremes. In general, however, the departure from the overall sample composition is more the rule than the exception for these detection strategies. What we observe is not a series of detection strategies that contribute a fairly even representation of offenses to the overall enforcement pool, but rather, methods quite idiosyncratic in offense composition that present an even distribution of offenses only in their aggregation. The insights derived from analysis in Chapter 6, that different offense vulnerabilities are sensitive to different detection strategies are indeed borne out by these data.

The important analytic question, however, is not whether or how much offense subpopulations based on detection method differ from the total population, but rather, how these differences are reflected in patterns of illegality. In the subsequent analysis, we will work our way down the rows of Table 7.2, examining these idiosyncratic offense distributions generated by particular detection methods. Furthermore, we will inquire about the

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[1]Of course, one reason social control agency referrals are more like the total sample than market surveillance is because they contribute significantly more cases (130 vs. 22 or 30% vs. 5%) to the sample.

possibility that, despite these idiosyncracies, there are classes of detection methods that are similar in the composition and distribution of offenses they uncover. Table 7.2 is a complex table with over 150 cells and twice that number of percentages that are relevant for particular analyses. I will try to keep the discussion simple, but urge the reader to closely scrutinize the table. If a picture is worth a thousand words, a table is worth at least that many.

Incursions

If there are classes of detection method which net similar "catches" of offenses, the reactive/proactive distinction is clearly not the one to use to make these classifications. Indeed the two most disparate of all the detection methods found in SEC intelligence are both proactive strategies: incursions and surveillance. The second row of Table 7.2 displays the distribution of offenses detected by incursions. By far, the most common offense (39%) so uncovered is that involving technical violations exclusively. This proportion is about twice that of the overall sample. Indeed, incursions provide 77% of all technical violation offenses that come to the attention of the SEC. The remaining offense categories are considerably less likely to be detected by incursive methods, although, for many of them, the proportion corresponds to the overall sample. The offenses which incursions tend to undersample (hence low proportions overall) are those involving registration violations either exclusively (5% vs. 11% overall), coupled with misrepresentation (11% vs. 18%), or coupled with both misrepresentation and misappropriations (9% vs. 13%).

The general category (2) incursions is an aggregation of the sub-categories of inspections, filings, and spin-offs. An examination of rows (2) in the middle portion of Table 7.2 indicates considerable heterogeneity in offense composition among these three components. The technical violation only offenses are detected by inspections, but especially by filings, more than half of which

are offenses of this kind. The only other offense that filings generate more than expected numbers of cases is that involving misrepresentations exclusively - presumably made in these very filings to the SEC. Inspections are a bit more versatile in the range of offenses detected. In addition to technical violations (22%), they are most likely to uncover misappropriations (22%) and manipulation or self-dealing (22%), the latter proportion however, not being appreciably higher than that of the sample overall. Both inspections and filings are very unlikely to uncover offenses by parties without formal relationships with the SEC, reflected in registration violations.

The spin-off component of incursions is misclassified from the perspective of offense composition. Unlike their counterparts, they are very unlikely to uncover technical violations (only 7% vs. 47% of inspections and filings) and much more likely to detect registration violations (15% vs. 2% of inspections and filings). What is distinctive about spin-off cases, both in contrast to other incursions and to the sample overall, is their greater likelihood to detect the more subtle, disembodied offenses of self-dealing and stock manipulation. Slightly over a third of the spin-off cases involve either self-dealing or manipulation in contrast to a fifth of the entire sample and 13% of other incursions. What is critical about spin-offs, from the offense perspective, is not that they involve incursive methods and greater access to settings of illegality, which they share with inspections and filings. Rather, in contrast to these other incursive methods which are basically static and ex post facto, spin-offs involve a broader and more dynamic perspective on illegal activity and a richness of detail that is afforded by extensive previous investigation of related activities and access to the conduct of parties bearing no formal relationship with the SEC.

Surveillance

In their special focus on matters of manipulation and self-dealing, spin-offs more closely resemble offenses uncovered by the other proactive detection strategy, surveillance. As the first row of Table 7.2 reflects, the proportion of surveillance cases involving manipulation or self-dealing (53%) is more than two and a half times that of the total sample. Indeed, with the exception of a greater likelihood than the sample overall to detect offenses involving nonregistration and misrepresentations, (24% vs. 18%, respectively) surveillance methods uncover little else. They are highly unsuited to detect either the static technical violation or the micro-level offense of misappropriation for which inspections are particularly suited. Surveillance methods did not uncover a single offense of either kind.

Like components of the incursion category, market and non-market surveillance (displayed in the middle portion of Table 7.2) are quite different in offense composition. Both strategies are extremely specialized in their "catch." As noted earlier, market surveillance uncovers little else but offenses based on self-dealing and manipulation (95% of them). Other surveillance methods are a bit more likely than the overall sample to detect offenses involving self-dealing or manipulation (26% vs. 20%) as well. But the largest proportion (53%) of offenses it uncovers are those which involve nonregistration and misrepresentations, especially without misappropriation. This finding reflects the reliance of this strategy on the surveillance of disembodied offense media, the typical example of which is misrepresentational literature concerning unregistered investments.

Detection Specific Offense Patterns

These five categories which constitute the proactive detection strategies - surveillance and incursions - reflect most of the detection specific offense

patterns found among all the detection methods. There is the filings pattern (1), which uncovers a disproportionate number of technical violations, (also characteristic of self-disclosures and referrals from self-regulatory agencies). There is the market surveillance or spin-off pattern (2), which uncovers a disproportionate number of the least apparent offenses of stock manipulation and self-dealing and a disproportionately small number of technical violations (also characteristic of referrals from informants). There is the other surveillance pattern (3), which detects elements of securities fraud involving misrepresentation, nonregistration and frequently misapproporiation, but uncovers disproportionately fewer technical violations (characteristic of referrals from investors, professionals, and state and federal agencies). There is perhaps a fourth pattern, of which inspections might be a member of the set, but certainly not an exemplar. This fourth pattern includes offenses involving misappropriation, either exclusively, or in combination with registration violations and misrepresentations. It is characterized by referrals from insiders and actual investors; the purely misappropriation offense is reflected in inspections.

These patterns are displayed in Figure 7.1, a rearrangement of data from Table 7.2. As the figure demonstrates, the assignment of detection methods to offense pattern categories has little regard for either reactive/proactive distinctions or those based upon the degree of access to illegality characterized by an investigatory source. The securities commuity is divided between patterns 2 and 3; other social control agencies between 1 and 3; insiders between 1 and 4. There is perhaps greater offense homogeneity in the investor and other social control agency categories than the others, but even in these categories heterogeneity is found. We now complete the analysis of offense patterning in cases detected by reactive methods, bearing in mind the

FIGURE 7.1: DETECTION SPECIFIC OFFENSE PATTERNS

% ACROSS	None	Technical Violations Only	Registration Violations Only	Misrepresentations Only	Registration Violations and Misrepresentations	Misappropriations Only	Registration Violations, Misrepresentations, and Misappropriations	Manipulation, Self-Dealing	TOTAL
PATTERN 1									
(2) Filings	0 0%	55 57%	2 2%	11 12%	8 8%	1 1%	6 6%	13 14%	96
(3) Self-Disclosures	0 0%	5 24%	4 19%	3 14%	2 10%	1 5%	3 14%	3 14%	21
(6) Self-Regulatory Agencies	0 0%	12 26%	6 13%	4 8%	7 15%	5 11%	7 15%	6 13%	47
PATTERN 2									
(1) Market Surveillance	0 0%	0 0%	0 0%	1 4%	0 0%	0 0%	0 0%	21 95%	22
(2) Spin-offs	1 2%	3 7%	6 15%	2 5%	5 12%	4 10%	6 15%	14 34%	41
(5) Informants	0 0%	2 9%	2 9%	1 4%	2 9%	3 14%	2 9%	10 45%	22
PATTERN 3									
(1) Other Surveillance	0 0%	0 0%	4 12%	3 9%	13 38%	0 0%	5 15%	9 26%	34
(4) Actual Investors	1 1%	1 1%	10 10%	9 9%	19 18%	17 16%	26 25%	22 21%	105
(4) Solicited Investors	0 0%	1 3%	5 16%	4 12%	10 31%	2 6%	7 22%	3 9%	32
(5) Professionals	1 4%	1 4%	0 0%	1 4%	11 39%	0 0%	7 25%	7 25%	28
(6) Federal Agencies	0 0%	0 0%	3 12%	4 16%	4 16%	1 4%	7 28%	6 24%	25
(6) State Agencies	0 0%	0 0%	8 14%	6 10%	18 30%	4 7%	11 19%	12 20%	59
PATTERN 4									
(3) Participating Insiders	0 0%	0 0%	0 0%	2 13%	3 20%	3 20%	5 33%	2 13%	15
(3) Employers	0 0%	0 0%	0 0%	0 0%	0 0%	2 50%	1 25%	1 25%	4
(4) Actual Investors	1 1%	1 1%	10 10%	9 9%	19 18%	17 16%	26 25%	22 21%	105
(2) Inspections	0 0%	8 22%	1 3%	2 5%	6 16%	8 22%	4 11%	8 22%	37

patterns which they share with proactive methods.

Insiders

Referrals from insiders, though small in number, are rather heteogenous in offense composition. Perhaps because of this heterogeneity, the insider category as a class is not terribly distinctive as an investigative source. Ironically, although presumably insiders have access to the richest data on illegality, they are less likely to refer offenses involving subtlety and more likely to refer the most apparent offenses. Fifteen percent of these referrals pertain to the more subtle offenses of stock manipulation and self-dealing in contrast to 20% in the overall sample; 36% pertain to offenses which involve the more blatant activity of misappropriation, in contrast to 22% of the sample. As described earlier in the dissertation, this paradox is a reflection of the disincentives for self-reporting. Offenses involving misappropriation often victimize or exclude other insiders, and therefore disclosure in this instance does not involve true self-reporting. The fact of misappropriation, then, is critical to referrals emanating from insiders. Take offenses which involve combinations of nonregistration and misrepresentation. For the overall sample, offenses of this kind are 5% more likely to be detected than when they also contain elements of misappropriation; for insider referrals they are 7% less likely to be detected if misappropriation is absent. This pattern is particularly characteristic of components of the insider category involving employers and participating insiders.

The offense composition of the third component, self-disclosures, is rather different. This is not surprising, since self-disclosures generally pertain to corporate conduct and not that of individuals. Hence, typically individual offenses like misappropriation and self-dealing are rarely uncovered by self-disclosures. Rather, self-disclosures typically allege technical (24%) or

simple registration violations (19%) or simple misrepresentations (14%). These three offenses comprise 57% of the self-disclosures in contrast to 40% of the overall sample. This category resembles the proactive filings category in many respects. Indeed, self-disclosures frequently take the form of filings.

The insider category is so small that it has been difficult to speculate about offense patterning. What is clear is that it is potentiallly the richest source of offenses, yet refers the fewest and the least significant cases compared with most other investigative sources.

The Securities Community

Referrals from the securities community are also an insubstantial source of investigation (11%), an unfortunate fact given the nature of the few offenses they do refer. Referrals from the securities community are most likely to pertain to three kinds of offense, the more complex, subtle, and least trivial of the offense constellations: misrepresentations coupled with nonregistration (26%), also coupled with misappropriations (18%) and manipulation or self-dealing (34%). The proportion of all other offenses detected is lower than that of the overall sample.

The two components of this category of the securities community, informants and securities professionals, are distinctive in offense distribution. Referrals concerning manipulation and self-dealing emanate from informants (45% of them); those concerning offenses involving misrepresentation and nonregistration and perhaps misappropriation, emanate from professionals (64% of them). Presumably, the lack of apparency of the former offense requires greater access to informational sources, characteristic of informants. Information about investment schemes emanating from professionals perhaps reflects the fact that offenses of this kind often require professional services of brokering, banking, communication, and the like, and therefore, like that of investors, the

participation of professionals is solicited.

Investors

The two largest reactive sources of investigation reflect referrals from investors and from other social control agencies. As noted above, the investor category is more homogeneous than many of the others. Investors are unlikely to detect technical violation offenses and are neither more nor less likely than the overall sample to uncover offenses involving registration violations or misrepresentations only or the less apparent offenses of self-dealing or stock manipulation. Consistent with the analysis of Chapter 6, investors are more likely to complain about less apparent, embodied phenomena more common in offenses involving nonregistration and misrepresentation together and involving misappropriation. Fifty-eight percent of all investor referrals concern offenses of this kind in contrast to 40% of the overall sample.

The major difference between actual and solicited investors is found in the role of misappropriations, a form of victimization unavailable to solicited investors who rarely have consummated securities transactions. So actual investors are most likely to refer matters involving misappropriation exclusively (16% vs. 9% for the overall sample) or the combination of misappropriation, nonregistration, and misrepresentation (25% vs. 13% for the sample overall) than offenses involving only nonregistration and misrepresentation (18% vs. 18% for the sample overall). This trend is reversed for solicited investors who rarely complain about misappropriations (6%), and are less likely to refer matters involving misappropriations, misrepresentations and nonregistration (22%) than only nonregistration and misrepresentation (31%). Perhaps, because of their more limited extent of involvement in illegality relative to actual investors, solicited investors are more likely to complain about the simple offenses of nonregistration (16% vs. 10%) and

misrepresentations (12% vs. 9%) and quite a bit less likely to refer the less apparent offenses of self-dealing and stock manipulation (9% vs. 21%).

Other Social Control Agencies

A similar pattern is found in the contrast between state and federal social control agencies, both distinctive primarily in their referral of matters involving both nonregistration and misrepresentation. Federal agencies resemble actual investors - referring more of those offenses also involving misappropriations (28%) than those which do not (16%); state agencies resemble solicited investors where misappropriations are less salient, the percentage of referrals being 19% and 30% respectively. State referral patterns also resemble those of non-market surveillance, with relatively similar percent distributions on other offenses. It is not surprising that states behave more like non-market surveillance and solicited investors than actual investors, since they tend not to be involved in actual illegal conduct and their scrutiny of micro-level activity like that of misappropriation is limited. It is really unclear why federal agencies differ from state agencies in this respect.

The third component of the other social control agency category, referrals from self-regulatory agencies is really an amalgam of the other detection strategies. Like filings, it contributes a higher proportion of technical violations (26%) than the overall sample (19%) and a lower proportion of offenses involving manipulation and self-dealing (13% vs. 20%). Unlike filings, however, it is able to detect registration violations (13% vs. 2% for filings and 11% for the sample overall).

The distribution of other offenses uncovered by self-regulatory agencies fairly closely resembles that of the overall sample distribution. This investigative source comes closer to resembling the overall sample distribution because it has access to many of the detection methods that characterize most of

the other sources. Self-regulatory agencies conduct both market and non-market surveillance, receive complaints from insiders, investors, and the securities community. But unlike other social control agencies, they have considerable incursive opportunities. The National Association of Securities Dealers, a major component of this category, is required to inspect its member broker-dealer firms, to compell disclosure, and to monitor firm compliance with SEC technical regulations. Hence, information on technical violations is both available and salient to self-regulatory agencies, and as a result, they refer more offenses of this kind than all other reactive sources combined.

Multiple Sources of Investigation

Finally, we examine the last two rows of Table 7.2 which reflect offense patterning for cases instituted as a result of more than one or different detection methods. As the data indicate, the probability of multiple detection and especially detection by different methods increases with increasing offense complexity. Technical violations are extremely unlikely to be subject to multiple detection. They comprise almost a fifth of the overall sample and one-twentieth of the category of multiply detected cases. On the other hand, the proportion of misrepresentation/nonregistration/misappropriation offenses is higher by 4% in the group of multiple sources and by 8% in that of different sources, and the proportion of self-dealing and misappropriation offenses is higher by 14% and 16% for multiple and different sources respectively. It may appear paradoxical that the more complex and subtle offenses are more likely to be caught several times than once. Most likely, with increasing complexity, offenses generate greater complicity, involvement and more diffused information that creates more opportunities for detection.

Detection and Offense Constellation: A Conclusion

A final note about Table 7.2: for none of the detection methods enumerated in the table are simple nonregistration or simple misappropriation offenses discriminating. The range of proportions arrayed in these columns is considerably circumscribed relative to the other offenses - between 0% and 19% for registration violations and between 0% and 16% for misrepresentations. There is some patterning by offense of course: many of the pattern 3 strategies (other surveillance, investors, other social control agencies) tend to be a bit higher on nonregistration than other sources. However, the important point is that, as indicated in Chapter 4, registration violations and misrepresentations are such fundamental elements of securities violations that they are likely to be uncovered by any number of means. Hence, unlike many of the other offenses, the reliance on a particular detection method will have potentially less impact on the pool of simple registration and misrepresentation offenses than on that of other offenses detected.

In short, four types of detection method have been discriminated on the basis of their relationship to offense constellation (summarized in Figure 7.1). They include: (1) strategies most likely to uncover violations of SEC technical regulations (filings, self-disclosures, referrals from self-regulatory agencies); (2) strategies most likely to uncover stock manipulation and self-dealing and especially unlikely to detect technical violations (market surveillance, spin-offs, informants); (3) strategies most likely to detect offenses that involve misrepresentation and registration violations alone, or coupled with misappropriation (investment schemes) and especially unlikely to detect technical violations (other surveillance, actual and solicited investors, professionals, federal and state agencies); and finally (4) strategies most likely to uncover offenses for which misappropriation is a central element

(participating insiders, employers, actual investors, inspections).

Differences in Offender Composition

In the previous section, the question of whether detection strategies differ in the kinds and distribution of offenses they uncover was examined. In this section, the question is repeated, this time with respect to offenders. How different would the aggregate of parties subject to SEC investigation look if a single strategy of detection were adopted or if rates of their use were altered? In analyses in Chapter 6, rather modest relationships between offender constellations and detection strategy and substantially stronger ones between offender registrant status and detection were described. Powerful correlations between offense type and detection strategy were just presented. Because of the strong correlation between offender constellation and offense type, described in Chapter 4, one would therefore expect differences in the characteristics and constellation of offenders whose activities are detected by different means. The nature of these differences, with respect to both single individuals and organizations and to offender constellations, are described in this section.

First, do detection strategies vary in their propensity to uncover offenses of individuals or organizations? As you might recall from Chapter 4, most investigations (78%) pertain to the activities of both individuals and organizations. Five percent concern the activities of individuals only, and 17% of organizations only. The "catch" of offenders distinctive of particular detection strategies tends to correspond to this overall pattern. There are some modest differences between strategies, however. Market surveillance, self-disclosures, actual investors, professionals, and state agencies are more or less equally likely to detect offenders of either kind (6% of individuals alone, 7% of organizations alone). Referrals by participating insiders and employers never concern organizations only (11% concern individuals alone).

Matters detected by remaining strategies - incursions, most other social control agencies, other surveillance, solicited investors, informants - more likely concern activities of organizations alone (20%) than of individuals alone (3%). These differences undoubtedly derive from offense differences by detection method and differing organizational/individual mixes by offense. For example, embezzlement tends to be an individual offense; hence referrals from participating insiders and employers, usually alleging embezzlement, pertain to individuals only. Technical violations tend to be organizational offenses; hence incursions, the major source of technical violations, generate investigations of organizations alone more frequently than of individuals alone.

Characteristics of Individuals

As noted in Table 7.3, most individual offenders subject to SEC investigation (83%) are officers, directors, sole proprietors, or control persons of organizations engaged in securities transactions. A much smaller proportion (30%)[2] are employees of these organizations. Detection strategies differ in the likelihood that they will uncover activities by individuals in the organizational upperclass or underclass. Cases detected by market surveillance (63% of them), referrals by employers (50%), informants (74%), and federal agencies (67%) are less likely than the sample overall, and non-market surveillance (97%), inspections (94%), and participating insiders (93%) are more likely than the sample overall to refer matters in which the "upperclass" are involved. Market surveillance (47% of them) and spin-off methods (55%) are more likely to uncover offenses involving employees; filings (10%) and solicited investors (19%) are less likely. Some of these patterns reflect differences by detection method in offenses uncovered. For example, market surveillance and

[2]Twenty-three percent of all cases involve offenders representing both officer and employee roles. Therefore, the sum of percentages generally exceeds 100.

TABLE 7.3: DETECTION AND ORGANIZATIONAL POSITION

% ACROSS	OFFICERS, ET. AL		EMPLOYEES		TOTAL CASES
(1) Surveillance	42	84%	17	34%	50
(2) Incursions	108	87%	33	27%	124
(3) Insiders	35	92%	13	34%	38
(4) Investors	100	86%	45	39%	116
(5) Securities Community	35	81%	13	30%	43
(6) Other Social Control Agencies	91	81%	30	27%	112
(1) Market Surveillance	12	63%	9	47%	19
(1) Other Surveillance	30	97%	8	26%	31
(2) Inspections	29	94%	10	32%	31
(2) Filings	60	90%	7	10%	67
(2) Spin-offs	25	76%	18	55%	33
(3) Participating Insiders	14	93%	4	27%	15
(3) Self-Disclosures	20	100%	8	40%	20
(3) Employers	2	50%	1	25%	4
(4) Actual Investors	86	86%	41	41%	100
(4) Solicited Investors	23	88%	5	19%	26
(5) Informants	14	74%	6	32%	19
(5) Professionals	21	88%	7	29%	24
(6) Federal Agencies	14	67%	5	24%	21
(6) State Agencies	49	88%	19	34%	56
(6) Self-Regulatory Agencies	31	82%	8	21%	38
TOTAL	305	83%	110	30%	366
More Than One Source	107	88%	43	35%	122
Different Sources	79	91%	30	34%	87

informants typically uncover stock manipulation schemes often engaged in by persons outside of securities organizations altogether. Other relationships reflect the occasions for reporting matters to the SEC or the degree of involvement of outsiders in securities violations and the likelihood that they will encounter upper or lower level organizational roles.

Characteristics of Organizations

Differences by detection strategy in characteristics of organizations subject to investigation are of greater significance than those of individuals. First, and not surprisingly, there are significant differences in the kind of organizations reflected in the catch of various detection strategies. These differences are displayed in Table 7.4, which presents the number of offenses that involve issuers, broker-dealers, or both issuers and broker-dealers by detection method. The latter category is also included in the former categories. Hence percentages across detection strategies are substantial, especially in the proportion of offenses involving stock issuers.

Differences with respect to stock issuers are greatest between the two proactive strategies, with a third of the incursions and 87% of the surveillance methods uncovering offenses involving issuers. As the middle portion of the table indicates, filings (33%) and particularly inspections (11%) rarely reveal violations by issuers. Insiders tend to be less likely to refer matters involving issuers, though the proportions vary considerably between self-disclosures (48%) and employers (25%), on the one hand, and participating insiders (73%), on the other. Self-regulatory agencies are also less likely (51%) to refer matters concerning issuers, in part, because a major component of this category, the National Association of Securities Dealers, has jurisdiction only over broker-dealers.

The proportion of matters concerning broker-dealers is more-or-less an

TABLE 7.4: DETECTION AND ORGANIZATIONAL TYPE

% ACROSS	ISSUERS		BROKER-DEALERS		BOTH ISSUERS AND BROKERS		TOTAL
(1) Surveillance	48	87%	18	33%	14	26%	55
(2) Incursions	55	33%	123	74%	23	14%	167
(3) Insiders	22	56%	17	44%	3	8%	39
(4) Investors	87	69%	51	40%	19	15%	126
(5) Securities Community	35	70%	25	50%	12	24%	50
(6) Other Social Control Agencies	87	67%	43	33%	8	6%	130
(1) Market Surveillance	19	86%	9	41%	8	36%	22
(1) Other Surveillance	30	88%	9	26%	6	18%	34
(2) Inspections	4	11%	36	97%	4	11%	37
(2) Filings	32	33%	70	73%	11	12%	96
(2) Spin-offs	23	56%	20	49%	9	22%	41
(3) Participating Insiders	11	73%	5	33%	1	7%	15
(3) Self-Disclosures	10	48%	10	48%	1	5%	21
(3) Employers	1	25%	3	75%	1	25%	4
(4) Actual Investors	74	70%	42	40%	15	14%	105
(4) Solicited Investors	22	69%	13	41%	7	22%	32
(5) Informants	14	64%	12	54%	4	18%	22
(5) Professionals	21	75%	13	46%	8	29%	28
(6) Federal Agencies	21	84%	4	16%	2	8%	25
(6) State Agencies	47	80%	10	17%	2	3%	59
(6) Self-Regulatory Agencies	24	51%	22	47%	2	4%	47
TOTAL	247	56%	217	49%	55	12%	440
More Than One Source	88	68%	57	44%	22	17%	129
Different Sources	64	68%	44	47%	18	19%	94

inverse of that pertaining to issuers, with incursions (74%) and referrals from the securities community (50%) most likely to generate investigations of this kind of offender. Apparently, other governmental agencies are not particularly interested in or aware of the misdeeds of brokers. Only 16% of the federal and 17% of the state agency referrals pertain to brokers. Non-market surveillance efforts are also unlikely to detect the activities of broker-dealers. Presumably the literature and media available for monitoring are much more likely to pertain to stock issuers than stock brokers. Only about a quarter of the cases generated by other surveillance concerned brokers, and two-thirds of these cases involving brokers also pertained to issuers. These figures contrast with proportions of broker-dealer offenders of 97% for the inspections, 73% for filings, and 49% for the sample overall.

The third column of Table 7.4 displays those cases in which offenders include both stock brokers and issuers, a relative rarity (12%) overall. The proportion of such an offender group is highest for market surveillance (36%), spin-offs (22%) and referrals by professionals (29%), solicited investors (22%) and employers (25%). These findings generally reflect the correlation of offense type and detection method, on the one hand, and that between offense type and offender composition, on the other. As noted earlier in the chapter, market surveillance and professionals tend to detect stock manipulation, an offense often requiring the collaboration of issuers and brokers. Solicited investors are solicited by brokers who conspire with stock issuers to push a particular speculative stock. The collaboration of brokers and issuers is therefore inherent in offenses of this kind. The association of cases spun-off from other investigations and offender groups which include both issuers and brokers is also not unexpected, since one of the reasons for spinning-off the investigation is the discovery of additional participants in illegal conduct.

A final insight to be derived from Table 7.4 concerns multiple investigative sources. As indicated in the bottom two rows of the table, cases involving issuers are slightly more likely and those involving brokers are slightly less likely to be detected by multiple sources, whether deriving from the same or different detection methods. Undoubtedly, this finding is an artifact of the strong negative correlation of both incursions and technical violations to multiple investigative source, and the fact that most incursions and technical violations pertain to broker-dealers.

So the choice of a detection strategy makes a considerable difference with regard to whether the offender pool is primarily composed of stock issuers, brokers, or a combination of both. Not only is the type of offender reflected in detection method, but, as analyses in Chapter 6 revealed, so is its registrant status. Proactive detection methods are more likely to uncover the offenses of registered stock issuers than reactive methods. Of all offenses involving issuers, the proportion that are registered with the Commision is 48% and 69% for surveillance and incursions, respectively, in contrast to proportions ranging from 22% to 41% for the reactive sources. Generally, the referrals from other social control agencies and actual investors are least likely to involve registered issuers. Although proactive measures are designed to monitor the conduct of agency registrants, it is noteworthy that non-market surveillance and spin-offs are still quite likely (37% and 48%, respectively) to discover violations by non-registrants. Somewhat surprisingly, this relationship is not as strong for broker-dealers. The matters uncovered or referred by all detection methods, save federal agencies, concerning brokers are quite likely (generally over 60%) to pertain to registered parties.

Finally, we consider whether the organizations subject to SEC investigation differ in more universal characteristics by detection strategy. The data

indicate, for example, that non-market surveillance, filings, and referrals by state agencies are most likely to uncover offenses by young organizations. More relevant and interesting, is the relationship of detection method to organizational size. Are methods equally versatile in uncovering offenses located in small organizations and in big ones? Given the degree of access and organization of particular detection methods, one would expect some differences by method in organizational size.

Table 7.5 presents the data on this relationship. Chapter 4 described the problems in collecting reliable data on organizational size. As a result, discriminations are necessarily incomplete and superficial. But it is possible, for example, to differentiate between small (N=137) and medium to large organizations (N=66). The percentages in Table 7.5 reflect these discriminations. The table also differentiates those cases in which data on original size is unknown, in which multiple organizations under investigation are of different sizes, or in which organizations are bankrupt. The last column of the table presents data only for those cases where orginal size is known and relevant. It displays the ratio of the number of cases in which organizations are medium or large to those which are small.

The data in Table 7.5 indicate that there are differences by detection method in organizational size. The most significant differences are found in the contrast between surveillance and other detection methods. It is not surprising that surveillance (and especially market surveillance) methods are the most likely to detect the offenses of large organizations, since they must rely on public information, often concerning exchange listed stocks, which is more likely for larger than for smaller organizations. The ratio of medium or large to small organizations is 4.50 for market surveillance and 1.00 for other surveillance, relative to .48 overall. The only other proactive strategy likely

TABLE 7.5: DETECTION AND ORGANIZATIONAL SIZE

% ACROSS	DON'T KNOW, MIXED		BANKRUPT		SMALL		MEDIUM, LARGE		TOTAL	RATIO MEDIUM, LARGE TO SMALL
(1) Surveillance	16	31%	6	12%	12	23%	18	35%	52	1.50
(2) Incursions	49	30%	44	27%	52	32%	19	12%	164	.37
(3) Insiders	7	19%	11	31%	10	28%	8	22%	36	.80
(4) Investors	28	23%	32	26%	41	34%	20	17%	121	.49
(5) Securities Community	13	28%	11	24%	11	24%	11	24%	46	1.00
(6) Other Social Control Agencies	30	24%	38	31%	43	35%	13	10%	124	.30
(1) Market Surveillance	6	32%	2	10%	2	10%	9	47%	19	4.50
(1) Other Surveillance	10	29%	4	12%	10	29%	10	29%	34	1.00
(2) Inspections	10	27%	11	30%	10	27%	6	16%	37	.60
(2) Filings	26	27%	25	26%	35	37%	9	9%	95	.26
(2) Spin-offs	15	40%	9	24%	7	18%	7	18%	38	1.00
(3) Participating Insiders	2	14%	4	29%	5	36%	3	21%	14	.60
(3) Self-Disclosures	5	25%	7	35%	4	20%	4	20%	20	1.00
(3) Employers	1	33%	0	0%	1	33%	1	33%	3	1.00
(4) Actual Investors	23	22%	30	29%	33	32%	16	16%	102	.48
(4) Solicited Investors	10	33%	3	10%	11	37%	6	20%	30	.55
(5) Informants	6	29%	7	33%	3	14%	5	24%	21	1.67
(5) Professionals	7	28%	4	16%	8	32%	6	24%	25	.75
(6) Federal Agencies	7	30%	8	35%	5	22%	3	13%	23	.60
(6) State Agencies	12	22%	15	27%	23	42%	5	9%	55	.22
(6) Self-Regulatory Agencies	9	20%	12	27%	18	40%	6	13%	45	.33
TOTAL	107	25%	111	26%	137	32%	66	16%	421	.48
More Than One Source	32	26%	31	25%	39	32%	21	17%	123	.54
Different Sources	26	29%	23	26%	26	29%	15	17%	90	.58

to be concerned with large organizations is that of spin-offs (ratio of 1) - an expected finding since spin-offs are more likely with an enlarging scope of investigation, a major source of which is the discovery of massive organizational offenders.

Among the reactive investigative sources, some of the major detectors of substantively significant securities fraud seem to be uncovering offenses of small organizations. The large/small ratio of cases referred by participating insiders, investors, and other agencies is less than .60. The reactive source most likely to uncover the offenses of large organizations is that of informants. Many of these cases pertain to stock manipulation, an offense that frequently involves large corporations. To a lesser extent, self-disclosures and those by securities professionals pertain to larger organizations. The important finding in this analysis is really the contrast between detection strategies with little access to illegality - surveillance, and the securities community - and those involving participants in the activities - participating insiders and investors - with much greater access. Those strategies with little access seem rather unsuited to uncovering the offenses of the small organization, and vice versa.

Offender Constellations

In Chapter 6, hypotheses that suggested that offender constellations pose different vulnerabilities to detection were evaluated. Here, we simply consider whether detection strategies net a different catch with respect to the size and type of offender constellations.

The scope of participation in illegality is reflected in two indicators, one that counts the number of offenders, another that counts numbers of individuals and organizations separately. Their relationships to detection strategies are displayed in Tables 7.6 and 7.7. Those detection strategies

uncovering offenses with large numbers of participants (Table 7.6) are a familiar group, often associated with other similar attributes of illegality. The strategies include participating insider referrals, a third of which pertain to five or more offenders, market (27% of them) and other (32%) surveillance, spin-offs (22%) and actual investors (20%). The detection strategies unlikely to net many offenders are also a familiar group: inspections, 54% of which pertain to one or two offenders, filings (60% of them), and referrals by self-regulatory agencies (55% of them). Because of the patterning of these constituent categories, the major differences among the general detection strategies are between incursions, on the one hand, and insiders and particularly surveillance, on the other.

Most likely, the explanation for the limited scope of participation in inspection/filing/self-regulatory cases is that they predominantly involve technical violations for which participation is generally relatively limited. The explanation for greater participation in offenses detected by participating insiders, surveillance, spin-offs and actual investors is less clear. It too may reflect the correlation of particular kinds of offenses to these detection strategies, or it may rather reflect capabilities in these strategies to uncover more widely participated offenses or limitations in their ability to scrutinize smaller offender groups.

Perhaps more relevant in defining the scope of offense participation than numbers of offenders is whether activities are contained in more than one organization. A case of self-dealing by four insiders in a corporation is a rather different (and in some sense less significant) matter than one in which principals in a securities issuing corporation and a brokerage firm collaborate to distribute a fraudulent stock offering.

Table 7.7 presents the relationship of detection to the number of

TABLE 7.6: DETECTION AND NUMBER OF OFFENDERS

% ACROSS	ONE		TWO		THREE-FIVE		MORE THAN FIVE		TOTAL
(1) Surveillance	5	9%	15	27%	18	33%	17	31%	55
(2) Incursions	44	26%	48	29%	51	30%	24	14%	167
(3) Insiders	3	8%	10	26%	18	46%	8	21%	39
(4) Investors	11	9%	38	30%	55	44%	22	17%	126
(5) Securities Community	5	10%	16	32%	21	42%	8	16%	50
(6) Other Social Control Agencies	19	15%	40	31%	51	39%	20	15%	130
(1) Market Surveillance	5	23%	3	14%	8	36%	6	27%	22
(1) Other Surveillance	1	3%	12	35%	10	29%	11	32%	34
(2) Inspections	5	14%	15	40%	12	32%	5	14%	37
(2) Filings	29	30%	29	30%	25	26%	13	14%	96
(2) Spin-offs	11	27%	4	10%	17	42%	9	22%	41
(3) Participating Insiders	1	7%	4	27%	5	33%	5	33%	15
(3) Self-Disclosures	1	5%	4	19%	12	57%	4	19%	21
(3) Employers	1	25%	2	50%	1	25%	0	0%	4
(4) Actual Investors	6	6%	33	31%	45	43%	21	20%	105
(4) Solicited Investors	5	16%	10	31%	12	38%	5	16%	32
(5) Informants	2	9%	7	32%	9	41%	4	18%	22
(5) Professionals	3	11%	9	32%	12	43%	4	14%	28
(6) Federal Agencies	3	12%	9	36%	10	40%	3	12%	25
(6) State Agencies	6	10%	13	22%	28	48%	12	20%	59
(6) Self-Regulatory Agencies	11	23%	15	32%	13	28%	8	17%	47
TOTAL	80	18%	138	31%	161	37%	61	14%	440
More Than One Source	8	6%	33	26%	57	44%	31	24%	129
Different Sources	6	6%	23	24%	39	42%	26	28%	94

TABLE 7.7: DETECTION AND SCOPE OF PARTICIPATION IN OFFENSE

% ACROSS	AT MOST 1 PERSON; AT MOST 1 ORGANIZATION		AT MOST 1 PERSON; 2 OR MORE ORGANIZATIONS		2 OR MORE PERSONS; AT MOST 1 ORGANIZATION		2 OR MORE PERSONS; 2 OR MORE ORGANIZATIONS		TOTAL CASES
(1) Surveillance	18	33%	9	16%	13	24%	15	27%	55
(2) Incursions	69	41%	11	7%	63	38%	24	14%	167
(3) Insiders	17	44%	1	3%	15	38%	6	15%	39
(4) Investors	51	40%	6	5%	44	35%	25	20%	126
(5) Securities Community	22	44%	3	6%	10	20%	15	30%	50
(6) Other Social Control Agencies	63	48%	6	5%	44	34%	17	13%	130
(1) Market Surveillance	5	23%	6	27%	5	23%	6	27%	22
(1) Other Surveillance	13	38%	3	9%	9	26%	9	26%	34
(2) Inspections	20	54%	2	5%	11	30%	4	11%	37
(2) Filings	42	44%	7	7%	34	35%	13	14%	96
(2) Spin-offs	10	24%	3	7%	18	44%	10	24%	41
(3) Participating Insiders	7	47%	0	0%	6	40%	2	13%	15
(3) Self-Disclosures	8	38%	1	5%	8	38%	4	19%	21
(3) Employers	2	50%	0	0%	1	25%	1	25%	4
(4) Actual Investors	42	40%	5	5%	39	37%	19	18%	105
(4) Solicited Investors	15	47%	1	3%	6	19%	10	31%	32
(5) Informants	10	46%	0	0%	6	27%	6	27%	22
(5) Professionals	12	43%	3	11%	4	14%	9	32%	28
(6) Federal Agencies	10	40%	3	12%	7	28%	5	20%	25
(6) State Agencies	27	46%	1	2%	22	37%	9	15%	59
(6) Self-Regulatory Agencies	24	51%	3	6%	18	38%	2	4%	47
TOTAL	189	43%	31	7%	155	35%	65	15%	440
More Than One Source	52	40%	6	5%	37	29%	34	26%	129
Different Sources	38	40%	4	4%	24	26%	28	30%	94

individuals and organizations involved in illegal actvities. The surveillance strategies are again quite likely to detect offenses with a greater scope of participation. Slightly over a quarter of both market and non-market surveillance cases involve more than one individual as well as more than one organization in contrast to 15% of the over-all sample. And again, inspections, filings and self-regulatory agency referrals are quite unlikely to uncover offenses of this magnitude. But many of the other major investigative sources of greater scope are not the same as those that detect large numbers of offenders. Participating insiders (13%), actual investors (18%) and state agencies (15%), sources of multiple offender cases, are, however, quite unlikely to uncover offenses involving more than one individual and organization. Rather, solicited investors (31%) and referrals from informants (27%) and professionals (32%) are the major sources of offenses of this kind.

These differences provide another perspective on the relationships between detection and offender constellations. Participating insiders and actual investors reflect intra-organizational diversity or scope, surveillance, members of the securities community and solicited investors reflect inter-organizational scope or diversity. What distinguishes these two groups is the access of a detection strategy to the conduct of illegal activity. Surveillance, the securities community, and even solicited investors are on the periphery of illegal activity. Participating insiders and actual investors are centrally involved in these activities. Perhaps detection is simplified for those strategies with only a peripheral perspective on illegality when additional organizations are drawn into these activities than when it is contained (and more readily concealed) in a single organization.

The Impact of Illegality

One aspect of the scope or magnitude of an offense pertains to the

constellation of its perpetrators. Another pertains to the impact of their activities. In this section, two elements of impact, concerning the extent of victimization and the economic cost of the offense, are considered. Chapter 4 contained a lengthy discussion, both descriptive and methodological, of the indicators of these phenomena. The reader should recall that there are some problems of missing and biased data with both of these variables. However, they are rich and reliable enough to get some sense for the differential impact of offenses detected by different methods.

Table 7.8 presents the relationship of detection and victimization. The first five columns of the table present data on numbers of victims as a percentage of those offenses in which victims were enumerated. The last two columns describe the cases that are omitted from this analysis, either because the offense did not generate victims or because they could not be enumerated. Percentages in these columns are based on the total number of cases generated by a particular detection strategy. The most striking finding in the table is the enormous variability by detection strategy in the proportion of cases in which victims or victimization data are absent. For 45% of the surveillance cases, victims could not be enumerated, in contrast to about a quarter of the other strategies. Problems of enumeration were highest (59%) for market surveillance, which is not surprising given that its characteristic disembodied offenses of stock manipulation and insider trading generate diffuse victims, not always easy to specify.

More significant is the variability found in Table 7.8 in the likelihood that any victims, whether or not enumerable, were generated by illegal activity. For more than half of the incursion cases (especially filings), no victims were generated, in contrast to 13% of all cases referred by investors, or 18% of those derived from surveillance. If the creation of victims is a reflection of

TABLE 7.8: DETECTION AND VICTIMIZATION

% ACROSS	1 - 25	26 - 100	101 - 500	501 +	TOTAL	NO VICTIMS	VICTIMS NOT ENUME-RATED
(1) Surveillance	3 15%	7 35%	5 25%	5 25%	20	18%	45%
(2) Incursions	15 48%	8 26%	6 19%	2 6%	31	56%	25%
(3) Insiders	7 39%	5 28%	4 22%	2 11%	18	26%	28%
(4) Investors	27 36%	24 32%	15 20%	8 11%	74	13%	27%
(5) Securities Community	5 21%	9 38%	7 29%	3 12%	24	28%	22%
(6) Other Social Control Agencies	23 35%	22 34%	16 25%	4 6%	65	25%	25%
(1) Market Surveillance	0 0%	2 67%	1 33%	0 0%	3	27%	59%
(1) Other Surveillance	3 18%	5 29%	4 24%	5 29%	17	15%	35%
(2) Inspections	7 78%	1 11%	1 11%	0 0%	9	38%	38%
(2) Filings	2 18%	5 46%	3 27%	1 9%	11	74%	15%
(2) Spin-offs	7 54%	3 23%	2 15%	1 8%	13	27%	39%
(3) Participating Insiders	2 22%	1 11%	4 44%	2 22%	9	7%	33%
(3) Self-Disclosures	2 33%	3 50%	0 0%	1 17%	6	43%	29%
(3) Employers	3 75%	1 25%	0 0%	0 0%	4	0%	0%
(4) Actual Investors	26 39%	19 29%	13 20%	8 12%	66	10%	27%
(4) Solicited Investors	2 14%	6 43%	4 29%	2 14%	14	25%	31%
(5) Informants	2 22%	2 22%	4 44%	1 11%	9	41%	18%
(5) Professionals	3 20%	7 47%	3 20%	2 13%	15	18%	25%
(6) Federal Agencies	5 50%	2 20%	1 10%	2 20%	10	20%	40%
(6) State Agencies	10 26%	16 42%	9 24%	3 8%	38	12%	24%
(6) Self-Regulatory Agencies	9 39%	4 17%	10 44%	0 0%	23	36%	15%
TOTAL	65 38%	57 34%	35 21%	12 7%	169	36%	25%
More Than One Source	19 32%	15 25%	19 32%	7 12%	60	16%	37%
Different Sources	12 27%	12 27%	14 32%	6 14%	44	15%	37%

the impact of an offense, the table indicates that those detection strategies with greatest impact in this respect are employers (0% no victims), participating insiders (7%), actual investors (10%), state agencies (12%), non-market surveillance (15%), professionals (18%) and federal agencies (20%). Those with least impact include filings (74%), self-disclosures (43%) and informants (41%).

However, the fact that a detection strategy has impact through the generation of victims does not insure that its impact is significant in terms of the number of victims so generated. Indeed, for many strategies, there seems to be a trade-off between the universality of victimization in the offenses they uncover and the number of victims typically involved in these offenses. For example, all offenses referred by employers involve victims, but none of them involve more than one hundred victims. In the case of informant referrals, the trade-off is reversed: relatively low proportions (59%) of victimizing offenses and very high proportions (55% relative to 29% overall) of offenses with more than one hundred victims. A similar tension is reflected in the contrast between actual and solicited investors. Actual investor referrals are more likely (90% vs. 75%) to pertain to victimizing offenses, but are less likely (32% vs. 43%) to involve more than one hundred victims. For other strategies, especially non-market surveillance (85% victimization, 53% more than 100 victims) and participating insiders (93% victimization, 66% more than 100 victims), the high likelihood of victimization is coupled with a high likelihood of substantial victimization.

So numbers of victims provide a unique insight on the impact of an offense. The most significant of the detection strategies in this regard, as indicated in Table 7.8, include participating insiders, non-market surveillance, informants,

solicited investors and multiple detection strategies. However, it is likely that where victims cannot be enumerated, it is because there are so many of them. So strategies with many unenumerated victims, like market surveillance and federal agency referrals, may also have significant impact reflected in extent of victimization, though data are unavailable to assess this speculation.

The relationship of detection to the impact of an offense reflected in economic terms is quite similar to that of victimization. As noted in Table 7.9, the detection methods of inspections, filings, and self-disclosures are most likely to uncover offenses in which there are no associated economic costs. This is true of half to three-quarters of these cases, in contrast to proportions of less than a quarter for non-market surveillance, participating insiders, employers, actual investors and state agencies - the same strategies most likely to generate victims. And like the victimization analysis, these strategies still differ significantly in the magnitude of impact. The really big cases in economic terms are most likely to be generated by other surveillance and participating insiders, 27% of both of which involve offenses in which in excess of $500,000 is at stake in contrast to 9% of the overall sample. A second tier of detection methods, which includes employers (25%) actual (19%) and solicited (15%) investors, professionals (18%) and state agencies (15%), are next in line as sources of these more expensive offenses. Multiple source cases would also be classified in this tier.

The fact that relationships concerning the magnitude of victimization and magnitude of cost bear similar relationships to detection method is not surprising. Offenses which generate victims also tend to incur monetary damage, and a major contributor to high economic cost is large numbers of victims. It is true that per capita victimization in securities offenses is not a constant. Figures presented in Chapter 6 indicate that, although the median per capita

TABLE 7.9: DETECTION AND ECONOMIC MAGNITUDE OF THE OFFENSE

% ACROSS	None	$1-$5,000	$5,001-$25,000	$25,001-$100,000	$100,001-$500,000	$500,001-$1,000,000	$1,000,001 +	TOTAL
(1) Surveillance	15 27%	2 4%	6 11%	8 14%	12 22%	6 11%	6 11%	55
(2) Incursions	103 62%	4 2%	13 8%	14 8%	26 16%	3 2%	4 2%	167
(3) Insiders	13 33%	0 0%	3 8%	8 20%	8 20%	3 8%	4 10%	39
(4) Investors	30 24%	5 4%	19 15%	34 27%	19 15%	9 7%	10 8%	126
(5) Securities Community	17 34%	2 4%	5 10%	9 18%	9 18%	4 8%	4 8%	50
(6) Other Social Control Agencies	42 32%	7 5%	12 9%	27 21%	27 21%	9 7%	6 5%	130
(1) Market Surveillance	8 36%	0 0%	4 18%	3 14%	4 18%	2 9%	1 4%	22
(1) Other Surveillance	8 24%	2 6%	2 6%	5 15%	8 24%	4 12%	5 15%	34
(2) Inspections	18 49%	1 3%	8 22%	3 8%	6 16%	1 3%	0 0%	37
(2) Filings	72 75%	2 2%	2 2%	5 5%	12 12%	2 2%	1 1%	96
(2) Spin-offs	17 42%	1 2%	3 7%	6 15%	10 24%	0 0%	4 10%	41
(3) Participating Insiders	3 20%	0 0%	0 0%	4 27%	4 27%	3 20%	1 7%	15
(3) Self-Disclosures	10 48%	0 0%	2 10%	5 24%	2 10%	0 0%	2 10%	21
(3) Employers	0 0%	0 0%	1 25%	0 0%	2 50%	0 0%	1 25%	4
(4) Actual Investors	18 17%	4 4%	16 15%	31 30%	17 16%	9 9%	10 10%	105
(4) Solicited Investors	13 41%	1 3%	5 16%	4 12%	4 12%	3 9%	2 6%	32
(5) Informants	8 36%	1 4%	2 9%	5 23%	3 14%	2 9%	1 4%	22
(5) Professionals	9 32%	1 4%	3 11%	4 14%	6 21%	2 7%	3 11%	28
(6) Federal Agencies	11 44%	1 4%	3 12%	2 8%	6 24%	1 4%	1 4%	25
(6) State Agencies	13 22%	1 2%	5 8%	16 27%	15 25%	5 8%	4 7%	59
(6) Self-Regulatory Agencies	18 38%	4 8%	3 6%	8 17%	8 17%	4 8%	2 4%	47
TOTAL	184 42%	18 4%	42 10%	77 18%	78 18%	21 5%	20 4%	440
More Than One Source	42 33%	3 2%	14 12%	23 18%	23 18%	9 7%	13 10%	129
Different Sources	29 31%	2 2%	10 11%	18 19%	17 18%	8 8%	10 11%	94

loss is less than $1,000, it ranges from under $500 (reflecting 31% of the cases) to in excess of $50,000 (reflecting 12% of the cases). Nonetheless, offenses that involve a large number of victims also involve a large amount of money. And it appears that non-market surveillance and participating insiders are most likely to uncover offenses of this kind.

Temporal Issues

Another aspect of the impact or significance of an offense is its duration. Presumably, longer duration offenses are of greater significance than offenses similar in other respects, but shorter. The longer duration suggests greater opportunities for illicit gain, for additional victimization, and for more prolonged victimization. Table 7.10 presents the relationship of detection to offense duration. Not surprisingly, those detection strategies most often associated with other indicators of impact are also associated with greater offense duration. Three-quarters of the referrals of employers, 53% of those by participating insiders, 47% of those by actual investors, 50% of those by professionals, and 45% of those by state agencies, in contrast to one-third of the sample overall, continued for more than two years. The very shortest duration offenses are most likely detected by market surveillance or self-disclosures, 60% and 48% of which continued for less than eight months, respectively.

As previous analysis has demonstrated, detection strategies are related to offense type, which in turn often varies in duration. For example, a simple stock manipulation, embezzlement or a non-fraudulent but unregistered stock distribution may take considerably less time to be enacted than a shell corporation investment scheme, which involves the acquisition of controlling shares of stock in a defunct corporation from disparate investors, manipulation of the price of these securities, and then the reselling of stock at manipulated

TABLE 7.10: DETECTION AND DURATION OF THE OFFENSE

% ACROSS	LESS THAN 8 MONTHS		8 MONTHS-2 YEARS		MORE THAN 2 YEARS		TOTAL CASES	MEAN DURATION (YEARS)
(1) Surveillance	20	39%	18	35%	13	26%	51	1.79
(2) Incursions	44	28%	63	40%	50	32%	157	2.28
(3) Insiders	12	31%	12	31%	15	38%	39	2.15
(4) Investors	24	20%	44	37%	50	42%	118	2.34
(5) Securities Community	13	29%	15	33%	17	38%	45	2.18
(6) Other Social Control Agencies	33	28%	47	40%	38	32%	118	1.83
(1) Market Surveillance	12	60%	6	30%	2	10%	20	1.12
(1) Other Surveillance	8	25%	12	38%	12	38%	32	2.28
(2) Inspections	9	26%	14	40%	12	34%	35	1.80
(2) Filings	30	33%	32	36%	28	31%	90	2.58
(2) Spin-offs	5	14%	18	49%	14	38%	37	2.45
(3) Participating Insiders	2	13%	5	33%	8	53%	15	2.61
(3) Self-Disclosures	10	48%	7	33%	4	19%	21	1.14
(3) Employers	1	25%	0	0%	3	75%	4	5.28
(4) Actual Investors	17	17%	35	36%	46	47%	98	2.47
(4) Solicited Investors	9	31%	11	38%	9	31%	29	2.09
(5) Informants	6	32%	9	47%	4	21%	19	2.10
(5) Professionals	7	27%	6	23%	13	50%	26	2.24
(6) Federal Agencies	6	26%	9	39%	8	35%	23	2.10
(6) State Agencies	8	14%	23	41%	25	45%	56	2.32
(6) Self-Regulatory Agencies	15	37%	17	42%	9	22%	41	1.45
TOTAL	121	30%	151	37%	134	33%	406	2.06
More Than One Source	24	20%	49	40%	48	40%	121	2.35
Different Sources	18	20%	38	42%	34	38%	90	2.20

prices. So the relationship between detection and offense duration may simply be an artifact of that between offense type and duration.

However this relationship may be accounted for by a different explanation entirely. Each of the analyses of detection and offense impact or significance have assumed that detection is a static process. They assume that there are numerous offenses in the real world, some more significant than others, and detection strategies simply pick and choose among these offenses. Such an assumption would be reasonable if these offenses had been completed and therefore their impact (reflected in duration, victimation, or monetary loss) fully realized. However, at least three-quarters of the offenses in the sample were still on-going at the time of detection. If detection has some impact on subsequent offense duration by shortening or forestalling illegal activities, then the point at which detection intervenes in the sequence of these activities is a critical factor in offense significance. A more realistic assumption, then, would suggest that detection strategies play a dynamic role in the making or unmaking of significant offenses. Those detection strategies associated with large numbers of victims, huge monetary costs, and long duration may be responsible for these very characteristics in their inability to quickly uncover illegal activities before the effects of these offenses are felt.

Perhaps the most apt contrast with respect to offense duration is that between offenses referred by actual and solicited investors. Recall that cases generated by actual investors tended to involve more money, a higher proportion of victimizing offenses, and longer duration than those generated by solicited investors. Assume that these offenses are of the same general character - fraudulent securities schemes in which specifiable investors are victimized. What differs between the two detection strategies is that solicited investors notify the SEC when they first learn of investment opportunities prior to making

an investment; actual investors wait to notify the SEC until after they have made the investment and then realize that they have been victimized. In the latter case, impact in terms of money and victims is generally greater, because detection of this kind facilitated greater offense duration. In other words, those detection strategies associated with insignificant offenses may be of greatest value because of their ability to intercept illegalities and foreclose their significant possibilities.

These speculations can be evaluated empirically with data on the interval between the inception of illegal activities and the time that suspicions or allegations of illegality are uncovered or reach the SEC. This relationship is displayed in Table 7.11. In this table, the unit of analysis is the detection strategy[3] and not the case, so the N is somewhat larger than in most other tables.

Some rather significant differences are found in Table 7.11. As indicated in the top portion of the table, an unusually high proportion of offenses detected by surveillance (23%) and incursions (25%) have been ongoing for less than two months in contrast to unusually high proportions of insiders (35%) and investors (33%) who refer offenses ongoing for more than two years.

Data found in the middle portion of the table confirm the speculation of the contrast between actual and solicited investors. Thirty-seven percent of the cases referred by solicited, in contrast to 7% of those by actual investors were ongoing for less than two months; 13% of those by solicited and 39% by actual investors had already continued for more than two years. In addition to solicited investors, some of most rapid detection methods are market surveillance, filings, and self-disclosures. Indeed, whereas about a third of

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[3]This is essential because offenses with multiple sources have multiple dates of detection for each source.

TABLE 7.11: DETECTION AND RECENCY OF THE OFFENSE (INTERVAL BETWEEN INCEPTION OF OFFENSE AND DETECTION)

% ACROSS	LESS THAN 2 MONTHS	2 - 6 MONTHS	6 MONTHS-1 YEAR	1 - 2 YEARS	MORE THAN 2 YEARS	TOTAL CASES
(1) Surveillance	12 23%	19 37%	5 10%	8 15%	8 15%	52
(2) Incursions	34 25%	25 18%	20 15%	24 18%	33 24%	136
(3) Insiders	5 14%	3 8%	7 19%	9 24%	13 35%	37
(4) Investors	18 14%	17 13%	28 21%	26 20%	44 33%	133
(5) Securities Community	3 7%	10 23%	10 23%	15 34%	6 14%	44
(6) Other Social Control Agencies	17 14%	20 16%	25 20%	28 23%	32 26%	122
(1) Market Surveillance	6 33%	8 44%	1 6%	3 17%	0 0%	18
(1) Other Surveillance	6 18%	11 32%	4 12%	5 15%	8 24%	34
(2) Inspections	8 24%	6 18%	8 24%	7 21%	4 12%	33
(2) Filings	25 30%	15 18%	7 8%	14 17%	23 27%	84
(2) Spin-offs	1 5%	4 21%	5 26%	3 16%	6 32%	19
(3) Participating Insiders	0 0%	0 0%	3 21%	4 29%	7 50%	14
(3) Self-Disclosures	6 29%	3 14%	4 19%	5 24%	3 14%	21
(3) Employers	0 0%	0 0%	1 25%	0 0%	3 75%	4
(4) Actual Investors	7 7%	11 11%	21 20%	24 23%	40 39%	103
(4) Solicited Investors	11 37%	6 20%	7 23%	2 7%	4 13%	30
(5) Informants	0 0%	4 21%	6 32%	7 37%	2 11%	19
(5) Professionals	3 12%	6 24%	4 16%	8 32%	4 16%	25
(6) Federal Agencies	2 9%	4 18%	4 18%	4 18%	8 36%	22
(6) State Agencies	6 11%	5 9%	13 24%	15 27%	16 29%	55
(6) Self-Regulatory Agencies	6 16%	10 27%	6 16%	8 22%	7 19%	37
TOTAL	89 17%	94 18%	95 18%	110 21%	136 26%	524

the cases in the sample had been ongoing for less than six months, this characterized more than three-fourths of the cases uncovered by market surveillance. In addition to actual investor referrals, some of the slowest detection methods include employers, participating insiders, and federal agencies; more than a third of the offenses they each uncovered had been initiated more than two years previously.

This differentiation of detection strategies based upon their speed of uncovering offenses is pretty much as might be expected. As offenses unfold, they generate different kinds of information and involve additional parties in facilitator or victim roles. If one generated a time line or chronology of a particular offense, noting the time that a corporate structure and physical plant is assembled, that advertising is issued, that brokers and investors are solicited, that stock market prices and data are affected, that actual investments are made, that investors realize they have been victimized, and so on, one would have a series of predictions about the timing of detection possibilities in accordance with the sequence of events.

The one major empirical exception to this predictive scheme is found in insiders - presumably the first to know and the last to tell. The insider category is an interesting one. Where the offender is the organization itself, self-disclosures are rather rapid. Where the employer is excluded from illegality (and perhaps is even its victim), he or she is one of the last to know and last to tell. Where the offender is an individual participant, presumably first to know, referral is very slow, presumably because events must unfold sufficiently for him or her to be disaffected or in some way disaffiliated enough to make referral a likelihood.

There is some variation by detection strategy in offense duration subsequent to detection. Although the proportion of ongoing offenses is greater

than 80% for most strategies, it is only 25% for employer referrals, 57% for filings, 64% for informants, 67% for market surveillance and participating insiders, 72% for actual investors. So those strategies most likely to detect offenses quickly - market surveillance and filings - and those least likely to do so - participating insiders, actual investors, employers - are most likely to detect completed offenses. This finding is puzzling, since other rapid detection methods such as solicited investors and self-disclosures are quite unlikely to uncover completed offenses. The fact that market surveillance and filings are both quick yet too slow in uncovering offenses is probably accounted for by the idiosyncratic kind of offenses they detect. Generally, those strategies which are slow to detect offenses are also more likely to discover already completed offenses.

These findings of considerable variation by detection strategy in the interval between offense initiation and detection lends support to the speculation that detection strategies make and unmake significant offenses by their speed in uncovering newly instituted illegal activities. We must therefore address the question of whether the relationship of other indicators of offense impact or significance and detection are simply artifacts of differential duration. It is difficult to address this issue systematically, because the necessary distinctions are more refined than the sample size warrants. It is the case, however, that both the number of victims and the economic cost of an offense are positively related, though weakly, to offense duration. So it is possible that the relationship of these indicators of impact and detection strategy may disappear when offense duration is controlled.

Table 7.12 presents the data that bear on this question. Because of small N's, duration, victimization, and economic cost are all dichotomized. The darkened cells in the third column of each subtable reflect those detection

TABLE 7.12: DETECTION AND RECENCY OF THE OFFENSE (CONTROLLING FOR OFFENSE DURATION)

% ACROSS	LESS THAN 1 YEAR % MORE THAN 100 VICTIMS	MORE THAN 1 YEAR % MORE THAN 100 VICTIMS	ALL CASES 1 YEAR % MORE THAN 100 VICTIMS	LESS THAN 1 YEAR % MORE THAN $100,000	MORE THAN 1 YEAR % MORE THAN $100,000	ALL CASES 1 YEAR % MORE THAN $100,000
(1) Surveillance	38%	58%	50%	58%	63%	60%
(2) Incursions	25%	29%	26%	33%	64%	52%
(3) Insiders	33%	33%	33%	0%	75%	58%
(4) Investors	35%	30%	31%	31%	47%	40%
(5) Securities Community	20%	56%	42%	44%	52%	52%
(6) Other Social Control Agencies	23%	37%	31%	46%	52%	48%
(1) Market Surveillance	0%	100%	33%	60%	33%	50%
(1) Other Surveillance	50%	54%	53%	56%	69%	65%
(2) Inspections	33%	0%	11%	22%	50%	37%
(2) Filings	0%	50%	36%	33%	79%	62%
(2) Spin-offs	33%	25%	23%	44%	64%	58%
(3) Participating Insiders	100%	62%	67%	0%	73%	67%
(3) Self-Disclosures	50%	0%	17%	0%	67%	36%
(3) Employers	0%	0%	0%	0%	100%	75%
(4) Actual Investors	33%	31%	32%	32%	48%	41%
(4) Solicited Investors	50%	56%	43%	33%	70%	47%
(5) Informants	0%	71%	56%	67%	40%	43%
(5) Professionals	25%	44%	33%	33%	64%	58%
(6) Federal Agencies	33%	33%	30%	57%	67%	57%
(6) State Agencies	18%	38%	32%	50%	53%	52%
(6) Self-Regulatory Agencies	33%	50%	44%	54%	53%	48%
TOTAL	24%	31%	28%	37%	54%	47%
More Than One Source	36%	49%	43%	43%	59%	52%
Different Sources	46%	47%	46%	43%	61%	54%

strategies most likely to uncover offenses with many victims and large economic costs. The two columns to the left present data controlled for offense duration. As these data indicate, for many of the detection strategies with greatest impact, controlling for duration makes no difference. Non-market surveillance still uncovers multiple victim, high cost offenses regardless of duration. And this is true of participating insiders, solicited investors, and self-regulatory agencies with regard to victims. But for the remaining darkened cells - informants with respect to victims, participating insiders, and employers with respect to money - proportions are high only for offenses of longer duration which continue for more than one year. Furthermore, other detection methods which overall do not detect large proportions of high impact offenses, do so for their long duration offenses. Among offenses which continue for more than one year, filings, self-disclosures, solicited investors, and federal agencies detect proportions of costly offenses as high, for example, as other surveillance. It appears, then, that although duration does not account for the impact of an offense entirely, it does contribute to the opportunities for impact. And to the extent that detection strategies can limit duration, they can limit the impact of offenses as well.

The Accuracy of Detection Strategies

The discussion of detection and offense duration introduced a new dimension to the evaluation of detection strategies. In addition to evaluation based on the quality of their "catch," evaluation can also reflect the quality of the strategies themselves. One aspect of quality is the speed of a detection strategy with regard to temporal features of an offense. Another aspect pertains to the accuracy of a detection method. Clearly, the correspondence between the suspicions or allegations of illegality which generate investigative work and the characterization of the offense, if any, at the conclusion of

investigation may be rather limited. Presumably, allegations emanating from positions of greater access to illegality may be more accurate than those based on intelligence strategies like surveillance without any access to these activities. And allegations by securities professionals with substantial expertise may be more accurate than those by unseasoned investors.

Another desirable characteristic of detection strategies in addition to their speed, then, is the accuracy of the intelligence they generate. Accuracy is a slippery concept, unfortunately. Are partial characterizations of a complex set of activities inaccurate? Are characterizations broader than the actual offense inaccurate? How does one treat allegations of offenses which do not exist, but which alert investigators to other violations? The data gathered in this research on initial allegations are not rich enough to consider questions of this kind, however they are to be resolved. Data are available, however, on investigations after which no violations of any kind were found regardless of the nature of initial suspicions. Detection strategies can be contrasted on the proportion of cases they generate for which no violation was discovered. Unfortunately a methodological caveat is necessary. As pointed out on several occasions earlier in this monograph, the docketing of cases is a highly discretionary process. And it is quite possible that investigators are more reticent to docket allegations from less trustworthy intelligence sources. Therefore, findings may be counterintuitive: the least trustworthy sources may appear most accurate because greater discretion is used in docketing these than the allegations of more trustworthy sources.

Table 7.13 displays the relationship of detection to the finding of a violation. The data are rather surprising: the least accurate strategies include surveillance, incursions, and referrals from the securities community, the most accurate include investors and insiders. Specifically, the strategies

TABLE 7.13: DETECTION AND THE FINDING OF A VIOLATION

% ACROSS	NO VIOLATIONS		TOTAL CASES
(1) Surveillance	9	16%	55
(2) Incursions	32	19%	167
(3) Insiders	2	5%	39
(4) Investors	8	6%	126
(5) Securities Community	10	20%	50
(6) Other Social Control Agencies	13	10%	130
(1) Market Surveillance	8	36%	22
(1) Other Surveillance	2	6%	34
(2) Inspections	1	3%	37
(2) Filings	26	27%	96
(2) Spin-offs	5	12%	41
(3) Participating Insiders	1	7%	15
(3) Self-Disclosures	1	5%	21
(3) Employers	0	0%	4
(4) Actual Investors	5	5%	105
(4) Solicited Investors	3	9%	32
(5) Informants	7	32%	22
(5) Professionals	3	11%	28
(6) Federal Agencies	3	12%	25
(6) State Agencies	3	5%	59
(6) Self-Regulatory Agencies	8	17%	47
TOTAL	65	15%	440
More Than One Source	10	8%	129
Different Sources	7	7%	94

of market surveillance (36%), filings (27%), and informants (32%) are most likely to eventuate in the finding of no violation, those least likely include non-market surveillance (6%), inspections (3%) all insider categories (0 - 7%), investors (5%, 9%), and state agencies (5%). As might be expected, since they involve fuller initial evidence, cases detected by multiple sources are more likely to result in the finding of actual violations than those detected by single sources.

The distribution of accuracy across detection categories contains several surprises. One would expect that referrals from investors would be exceptionally inaccurate because of their lack of experience in the securities arena and of knowledge of the technical details of securities law. One would have expected among these referrals many complaints of investors stung by misfortune in speculative but fully licit investment deals. Instead, one finds investor referrals one of the most accurate of all detection strategies, indeed more accurate than most of the proactive methods conducted by the more knowledgeable and sophisticated SEC staff. Of course, this finding may be the consequence of discretionary docketing practice. It is quite likely that if all investor complaints were docketed, the proportion of inaccuracy would increase significantly. Still, the high accuracy rate is noteworthy. The moderately high rate of inaccuracy (12%) for spin-off cases is also surprising. Since they are the outgrowth of considerable previous investigation, one would expect that the certainty of further violation worthy of investigation would be rather strong for these cases.

Other interesting contrasts are between market (36%) and other surveillance (6%), informants (32%) and professionals (11%), federal (12%) and self-regulatory agencies (17%) and state agencies (5%). In these cases, the variability within categories seems greater than that between categories. The

surveillance and securities community contrasts reflect the fact that market surveillance and informants often disclose stock-manipulation and self-dealing, offenses very difficult to detect and to prove. The high rates of inaccuracy probably reflect the difficulty of detecting offenses of these kinds. Furthermore, it is not surprising that a detection method like market surveillance is inaccurate, since it is based on an inferential model that generates suspicions about illegaility on the basis of information only marginally related to illegality. Market surveillance inferences are like guessing that an individual is a thief because he dresses better or drives a more expensive car than his co-workers. What is surprising is that non-market surveillance, which also must rely on marginal evidence, is not more inaccurate than it is. The greater accuracy of SEC inspections (3% inaccurate) most likely derives from the incursive opportunities and the clarity and centrality of evidence available to inspectors.

The explanation for variability within the category of other social control agencies is less clear. The greater inaccuracy of federal relative to state agencies may derive from the fact that many federal referrals often involve a request that the SEC determine whether there are any securities implications in federal offenses investigated by other agencies, rather than actual allegations of securities violations. The even higher proportion of no violation cases generated by self-regulatory agencies, with the same jurisdiction and interests as the SEC, remains puzzling. Perhaps the fact that some of these agencies also engage in market surveillance contributes to their inaccuracy rate.

As indicated in Table 7.13, overall the most accurate of the detection methods are found among the reactive rather than the proactive strategies. A hasty policy decision might suggest, therefore, that since proactive detection strategies often require greater agency resources and are less likely to uncover

actual securities violations, proactive strategies, or at least their inaccurate components, be curtailed. Such a policy decision would be reasonable if all detection strategies uncovered the same kinds of offenses. This assumption is cleary inappropriate in this setting, where detection methods vary not only in the kinds of offenses and offenders uncovered but in the seriousness or impact of these offenses as well. This is particularly true for the least accurate strategies that typically uncover some of the most distinctive kinds of offenses in the sample.

The tension between allocating resources between predominantly accurate and more inaccurate detection methods is reminiscent of that between Type I and Type II errors in statistical analysis. In one case, one sets the confidence limits in testing a hypothesis so narrowly, that it is unlikely that one would ever err by not rejecting a hypothesis that was really false. Accuracy is assured, but the true hypothesis may be rejected in the process. In the other case, the confidence limits are set so broadly that false hypotheses are not being rejected. The setting of limits, then, has associated costs. In one case, all detected offenses will prove to be prosecutable violations but many significant offenses will never be detected. In the other case, a wider set of offenses will be uncovered, but many will later prove to be unprosecutable.

Policy trade-offs of this kind will be addressed more fully in the concluding chapter. It should be noted here, however, that the generation of prosecutable violations is not the only purpose of an enforcement process. Another aim may be deterrence, and for this purpose, it may be necessary to attempt to detect as broad a spectrum of offenses and offenders, whatever the prosecutorial outcome, to assure potential offenders that they are not immume from detection, and hence, from the enforcement process.

Offense Significance

An important theme that runs through this chapter pertains to differences in the significance of offenses detected by various methods. Aspects of significance include the nature of an offense, its duration, scope of participation, and impact. Because of limited sample size, it is not possible to mount a sophisticated multivariate analysis of detection and indicators of offense significance. It is possible, however, to array offenses with respect to the number of elements of significance reflected in their execution.

The result is an additive "offense significance" scale, described in detail in Appendix F. It is based upon information concerning the offense itself, its duration, the number of offenders, the number of victims, and the economic magnitude of the offense. Scores pertaining to victimization and economic magnitude were weighted twice those pertaining to the other components, since they come closer to elements of impact and seriousness. As described in the Appendix, an offense that had elements of stock manipulation or self-dealing, continued for more than four years, involved more than fifteen offenders, more than 1,000 victims, and more than $2,500,000 would receive the highest score of "36." The following illustrations of one of the least significant (EXAMPLE A) and one of the most significant (EXAMPLE B) cases in the sample illustrate the distinctions implicit in this scale.

EXAMPLE A:

In October, 1962, the National Association of Securities Dealers informed the SEC that a particular New York broker-dealer firm was employing an individual who had been the subject of previous enforcement action. Investigation of these allegations disclosed that this man had never been employed by the firm because of personality conflicts.

This case was assigned a score of "0." The allegation pertained only to a technical violation, and there were no

victims, no money involved, only one alleged offender, and no offense duration.

EXAMPLE B

This case was generated by three different detection methods. The first, non-market surveillance, involved the discovery in April, 1959 of newspaper advertising about investment opportunities. The company was thereafter called in for questioning, but nothing was resolved. In October, 1962, an attorney noticed another ad and alerted the SEC. The company was called in again, and again, nothing was resolved. In December, 1962, it was learned during the course of an investigation of an unregistered securities issuer that the offenders in the present case were also involved with that issuer, and this investigation was spun-off.

The president and owner of all the voting stock of a Colorado finance company directed the company's affairs and was primarily responsible for its activities. Initially, the company was involved in the finance and small loan business, whereby it would make loans on cars, furniture, appliances, and other items. During the almost ten years of the company's existence, the president, with the assistance of the vice president and treasurer, caused the company to offer and sell to the public more than $5,000,000 worth of unregistered securities (demand notes and debenture notes) through misrepresentation. Representations were made to the public through an intensive interstate advertising campaign, utilizing radio, TV, newspapers, as well as literature and brochures. The principal representations made were that the company would pay interest ranging from 11 1/2 - 12 1/2%, that such investments were safe and were secured by all corporate assets, and that these funds would be used by the company in conducting its small loan business. However, only a small portion of these funds were committed to consumer loans. Most were invested in and loaned to highly speculative business ventures, many of which were being promoted, financed, or operated by the offenders. In some instances, the offenders were officers or directors of these ventures. In most instances, the companies could not even pay the interest on the loans, let alone the principal. Usually all of these investments and ventures proved to be financial debacles. As the financial condition of the company worsened, they intensified the advertising campaign in search of new investors, additional funds from existing investors, and the retention of existing deposits. The company offered and credited additional bonus interest to the accounts of investors, published and distributed statements to the effect that the company had in excess of $2,000,000 in assets, and made false and misleading bookkeeping entries which balooned the assets to disguise the company's insolvency. The books were kept in such a

fashion to give an appearance of solvency. In fact, for more than a three year period, the company was at all times deeply insolvent, and had to pay and credit interest payments and return principal out of funds supplied by new investors (a ponzi arrangement). During all this time, the president was earning a substantial salary and used expensive cars and a home purchased by the company. Eventually, the corporation filed a voluntary petition for Chapter X bankruptcy. At that time, claims of more than 2,000 investors totalled $2,800,000. The corporation had only $800,000 in assets. The reorganization resulted in a return to investors of 10 cents on every dollar. Many of the investors were elderly persons of modest means as well as servicemen.

The investigation resulted in the imposition of permanent injunctions against the corporation and the three officers, with ancillary remedies of the appointment of a receiver and the production of books and records. All three individuals were indicted and plead guilty or nolo contendere. The president was sentenced to four years imprisonment. The other two defendants were sentenced to 2 years probation and $1,000 fines.

This case received a score of "33," the maximum score on every item, except on the number of offenders.

Table 7.14 displays the relationship of detection to a recoded version of the significance scale as well as the mean significance score for each strategy. The abbreviated scale was designed to capture equal proportions of the distribution of significance scores for the total sample. It is clear from the table that this distribution is rather uncharacteristic of particular detection strategies. As the upper portion of the table reflects, the least significant offenses are detected by other social control agencies and especially by incursions. There is little difference in significance among the remaining investigative sources.

The middle portion of the table specifies the source of these differences. As reflected in (a) the mean significance score, (b) the proportion of at least significant offenses, and (c) the proportion of very significant offenses, those detection strategies most likely to uncover significant offenses include (in

TABLE 7.14: DETECTION AND OFFENSE SIGNIFICANCE

% ACROSS	VERY INSIGNI-FICANT	INSIGNI-FICANT	MODERATELY SIGNIFICANT	SIGNIFICANT	VERY SIGNIFICANT	TOTAL CASES	MEAN SIGNIFICANCE
(1) Surveillance	3 6%	7 13%	15 27%	13 24%	17 31%	55	17.2
(2) Incursions	62 37%	36 22%	24 14%	26 16%	19 11%	167	10.1
(3) Insiders	7 18%	5 13%	6 15%	9 23%	12 31%	39	15.5
(4) Investors	6 5%	17 14%	29 23%	35 28%	39 31%	126	16.9
(5) Securities Community	3 6%	12 24%	6 12%	14 28%	15 30%	50	16.2
(6) Other Social Control Agencies	17 13%	23 18%	20 15%	37 28%	33 25%	130	15.0
(1) Market Surveillance	1 4%	3 14%	9 41%	5 23%	4 18%	22	15.3
(1) Other Surveillance	2 6%	5 15%	6 18%	8 24%	13 38%	34	18.3
(2) Inspections	5 14%	13 35%	7 19%	8 22%	4 11%	37	12.1
(2) Filings	36 37%	21 22%	7 7%	8 8%	10 10%	96	7.9
(2) Spin-offs	7 17%	4 10%	11 27%	12 29%	7 17%	41	14.5
(3) Participating Insiders	1 7%	1 7%	1 7%	5 33%	7 47%	15	19.9
(3) Self-Disclosures	6 29%	4 19%	4 19%	3 14%	4 19%	21	12.0
(3) Employers	0 0%	0 0%	1 25%	1 25%	2 50%	4	19.8
(4) Actual Investors	2 2%	9 9%	27 26%	31 30%	36 34%	105	18.0
(4) Solicited Investors	5 16%	9 28%	3 9%	6 19%	9 28%	32	14.6
(5) Informants	2 9%	5 23%	3 14%	5 23%	7 32%	22	15.2
(5) Professionals	1 4%	7 25%	3 11%	9 32%	8 29%	28	16.9
(6) Federal Agencies	4 16%	0 0%	10 40%	7 28%	4 16%	25	15.0
(6) State Agencies	2 3%	9 15%	3 5%	22 37%	23 39%	59	18.1
(6) Self-Regulatory Agencies	10 21%	10 21%	8 17%	7 15%	12 26%	47	12.9
TOTAL	93 21%	81 18%	81 18%	97 22%	88 20%	440	13.5
More Than One Source	6 5%	20 16%	29 22%	32 25%	42 33%	129	16.9
Different Sources	4 4%	14 15%	16 17%	28 30%	32 34%	94	17.5

decreasing order of significance): participating insiders (80% at least significant), employers (75%), state agencies (76%), non-market surveillance (62%), actual investors (64%), professionals (61%), and informants (55%). In contrast to these strategies, 74% of all filing matters are at best insignificant, as are 49% of the inspections, 48% of the self-disclosures, 44% of the solicited investors, and 43% of the self-regulatory agency referrals. At the significant pole of the scale, the data indicate a range of less than a fifth of the filings to four-fifths of participating insider referrals; at the insignificant pole, a range of none of the employers to almost three-quarters of the filings. Also note from the bottom rows of Table 7.14 that the more significant offenses are a bit more vulnerable to multiple detection than the less significant offenses.

Table 7.15 presents the mean scores for each component of the significance scale by detection strategy. The darkened cells reflect those strategies with the highest mean scores. As the table indicates, those strategies deemed most significant overall earned this designation by receiving relatively high scores on each of the component measures. Each of the five most significant detection methods received the highest scores on victimization, economic magnitude, and duration. Other surveillance, participating insiders, and actual investors received high scores on the number of offenders; and other surveillance and employers received highest scores on the type of illegality.

Of the component items, those of number of offenders, and type of illegality are less likely to define the most significant detection strategies. The number of offenders criterion does little to differentiate the detection methods. The offense type distinction emphasizes offenses involving stock manipulation and self-dealing, which previous analysis indicated were most likely to be detected by surveillance or the securities community.

TABLE 7.15: SIGNIFICANCE SCALE COMPONENTS (MEAN SCORES)

% ACROSS	VICTIMIZATION	ECONOMIC MAGNITUDE	NUMBER OFFENDERS	DURATION	TYPE ILLEGALITY	TOTAL SCORE
(1) Surveillance	3.31	5.04	1.98	2.11	4.78	17.2
(2) Incursions	1.44	2.51	1.39	2.33	2.46	10.1
(3) Insiders	3.13	4.64	1.85	2.62	3.28	15.5
(4) Investors	3.78	4.87	1.75	2.73	3.79	16.9
(5) Securities Community	3.38	4.44	1.64	2.44	4.28	16.2
(6) Other Social Control Agencies	3.30	4.38	1.60	2.29	3.39	15.0
(1) Market Surveillance	1.95	4.23	1.91	1.41	5.82	15.3
(1) Other Surveillance	4.09	5.41	1.97	2.65	4.15	18.3
(2) Inspections	1.73	3.08	1.57	2.41	3.27	12.1
(2) Filings	0.97	1.67	1.30	2.23	1.76	7.9
(2) Spin-offs	2.39	4.15	1.61	2.59	3.80	14.5
(3) Participating Insiders	4.73	5.73	1.93	3.43	4.13	19.9
(3) Self-Disclosures	2.19	3.48	2.00	1.76	2.57	12.0
(3) Employers	3.75	7.00	1.00	3.75	4.25	19.8
(4) Actual Investors	3.99	5.35	1.83	2.86	3.93	18.0
(4) Solicited Investors	3.38	3.81	1.59	2.28	3.50	14.6
(5) Informants	2.91	4.14	1.68	2.27	4.23	15.2
(5) Professionals	3.75	4.68	1.61	2.57	4.32	16.9
(6) Federal Agencies	3.04	3.88	1.52	2.52	4.04	15.0
(6) State Agencies	4.22	5.24	1.78	2.91	3.92	18.1
(6) Self-Regulatory Agencies	2.98	3.87	1.51	1.83	2.72	12.9
TOTAL	2.61	3.86	1.55	2.26	3.20	13.5
More Than One Source	3.52	4.56	1.94	2.73	4.12	16.9
Different Sources	3.61	4.74	2.00	2.70	4.41	17.5

The finding that the major predictors of significant offenses, as conceptualized by the significance scale, include victimization, offense magnitude and duration is troubling. If previous speculations, that strategies that allow greater offense duration provide greater opportunities for more extensive victimization and economic harm is true, the scale may have selected as significant those detection methods that are most dilatory. To examine this possibility, significance scores were recomputed excluding information on offense duration and separate scores were computed for that subgroup of offenses which were enacted in less than one year (N=203) and those enacted in more than one year (N=273). If this interpretation about the assignment of significance scores were true, the differences across detection strategies in relative scores would disappear with the introduction of controls for offense duration.

The data pertaining to this question are presented in Table 7.16. Analysis of the table suggests that these suspicions are groundless. It is indeed the case that greater duration is associated with greater significance as reflected in other indicators of this phenomenon. Longer offenses are more significant than shorter ones. Overall, the mean significance score increases from 10.0 to 12.6 as those offenses enacted in less than one year are contrasted with those which continued for more than one year. And mean scores increase with duration for most of the detection strategies. However, the increase is much greater for the detection strategies associated with <u>less</u> significant offenses than those associated with more significant ones. Of the five strategies with highest overall significance scores (other surveillance, participating insiders, employers, actual investors, and state agencies) the percentage increase in mean significance score from less than one year to more than one year is 7% (from 14.70 to 15.79); for the remaining detection strategies, it is 39% (from 8.67 to 12.01). Furthermore, offense significance scores are higher among the former

TABLE 7.16: DETECTION AND MEAN SIGNIFICANCE SCORE (EXCLUDING DURATION)

% ACROSS	LESS THAN 1 YEAR DURATION	GREATER THAN 1 YEAR DURATION	ALL CASES
(1) Surveillance	14.4	16.4	15.4
(2) Incursions	6.3	9.5	8.0
(3) Insiders	7.9	15.4	12.9
(4) Investors	13.3	14.6	14.2
(5) Securities Community	11.1	15.8	14.0
(6) Other Social Control Agencies	11.4	14.1	13.0
(1) Market Surveillance	14.8	12.7	14.1
(1) Other Surveillance	13.8	17.2	15.9
(2) Inspections	8.6	10.7	9.7
(2) Filings	3.8	7.7	5.8
(2) Spin-offs	11.7	13.1	12.6
(3) Participating Insiders	13.5	17.0	16.5
(3) Self-Disclosures	8.1	12.6	10.2
(3) Employers	11.0	17.7	16.0
(4) Actual Investors	15.1	15.2	15.1
(4) Solicited Investors	9.2	14.6	12.2
(5) Informants	9.9	15.6	13.5
(5) Professionals	11.9	15.9	14.3
(6) Federal Agencies	11.9	13.7	12.9
(6) State Agencies	15.1	15.7	15.6
(6) Self-Regulatory Agencies	9.9	12.8	11.4
TOTAL	10.0	12.6	11.5
More Than One Source	12.5	15.1	14.2
Different Sources	12.5	15.9	14.7

strategies than among the latter strategies for both categories of offense duration. So the more important strategies tend to be significant despite duration,[4] the less important stategies appreciate their significance considerably where offenses are lengthy. Although some of these more significant detection methods tend to be dilatory, they detect offenses that are already significant; they do not create significance by facilitating longer offense duration.

Conclusion

The evaluation of the offense significance scale and the finding that participating insiders, employers, state agencies, non-market surveillance, actual investors, professionals, and informants uncover the most significant cases, and that filings, inspections, self-disclosures, solicited investors, and self-regulatory agencies uncover the least significant offenses, is perhaps an apt conclusion to this chapter. But although the significance scale helps highlight distinctions based on types of illegality, offender constellations, offense duration, and impact, it obscures other features of detection strategy described in the chapter. For example, it obscures the tensions between these features - that strategies which detect significant offenses in numbers of individual participants may also uncover offenses insignificant in the organizational dimension of participation, that detection strategies most likely to uncover victim generating offenses may uncover offenses with typically small numbers of victims, that detection strategies most likely to uncover significant offenses are more likely to uncover offenses which have ended and are stale, that strategies likely to uncover offenses more quickly after their inception

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[4]One exception to this characterization is the category of referrals from employers. However, the N is only 4, and associated statistics therefore are very unstable.

are also more likely to generate inaccurate allegations of illegality.

In short, the choice of detection strategies involves important trade-offs in the nature and quality of offenses uncovered. Each detection strategy provides a unique perspective on illegality and utilizes its own distinctive binoculars and blinders in creating this perspective. A rich and balanced program of enforcement must juggle these strategies. The final chapter of this monograph systematically considers these trade-offs and the juggling act they create.

CHAPTER 8: DETECTION AND THE ENFORCEMENT PROCESS

In this concluding chapter of the dissertation, its major findings will be reviewed and their implications for SEC enforcement practice and for intelligence processes more generally will be examined.

The Generalizability of the Research

One of the most important questions to be asked of this research, when scrutinizing its findings for their implications for both theory and policy, concerns the extent to which the data are generalizable. Chapter 2, on research method, addressed in considerable detail questions of the correspondence of investigative records to enforcement work, of the circumstances under which allegations of illegality are or are not docketed as investigative cases, of the boundaries of the population from which the research sample was drawn, all technical matters with substantial import for the generalizability of research findings. Here I wish to address a less technical concern, however, the implications of the fact that the research is based upon historical data.

As described in Chapter 2, the archival phase of the research pertained to investigations initiated between 1948 and 1972. The research could not consider more contemporary investigative practice because the SEC denied me access to investigations still open at the time the sample was drawn in 1977.[1] Thus, the most recent cases in the sample are now at least seven years old, and the investigations of median age, about eighteen years old. How useful, then, are these historical data? For analytic questions of the kind considered in the dissertation, these data are eminently useful.

At the univariate level, pertaining to rates of SEC detection strategy and

[1]See Chapter 2 for further details.

their distribution, the data may not be generalizable to contemporary practice. It is certainly possible that agency policy or the allocation of resources or of incentives associated with intelligence have changed in recent years. Perhaps with the wonders of computer technology, market surveillance has become more imaginative and accurate. Perhaps the post-Watergate atmosphere and the disclosures of the international bribery scandals (Kennedy and Simon 1978, U.S. Securities and Exchange Commission 1976) that followed in its wake have resulted in sensitizing investors and shareholders of American corporations to the possibility of corporate wrongdoing and thereby increasing their referral rate. Or perhaps these events have created closer ties among law enforcement agencies, resulting in a more substantial caseload referred to the SEC from other social control agencies. Or perhaps the impact of fluctuations in the securities markets has been felt on the intelligence front as well. For example, David Ratner has suggested that levels of investor dissatisfaction with the securities markets (and, thus, perhaps their rate of disclosure) are lessened when the market is in an upward trend (1971, pp. 583-4). This would suggest that rates of investor complaint may have increased over the past decade. Or perhaps there have been longitudinal changes in the distribution of offenses and therefore in offense vulnerabilities as well. Changing detection practices may simply reflect these changing vulnerabilities.

For all of these reasons, the research findings may not accurately portray the constellation of SEC intelligence strategies in force in 1977, nor may that of 1977 portray present practice, nor, for that matter, may present practice portray intelligence activities five years hence. If anything, relying on a much wider twenty-five year perspective has probably provided a much fuller and better anchored portrait of the diversity and fluctuations of intelligence strategies within the SEC intelligence repertoire than would a focus on a more

limited contemporary snatch of history.

An additional insight on the possible extent of fluctuation and change in intelligence constellations is provided by a longitudinal analysis of the twenty-five year spread of the research data with respect to detection practices. Unfortunately, given limited sample size and countless viable longitudinal discriminations, an analysis of this kind cannot be especially sophisticated. Nonetheless, concerns about possible volatility in SEC detection strategies can be quickly laid to rest. Longitudinal analysis of the temporal distribution of detection methods reveals few trends or patterns. Even with respect to market surveillance, an intelligence activity aided tremendously by the recent development of computer technology, the proportion of market surveillance cases has barely increased since 1948. The only consistent change over the twenty-five year period of the research is a decline in the proportion of investigations generated by investor complaints from 35% of the cases in 1948-52 to 18% in 1968-72.

In short, it would be unwise to suggest that univariate research findings are fully generalizable to contemporary intelligence practice, although such inferences may well be more reliable than one might think. Hence, the distribution of these data may not reflect that of contemporary practice; nor, for that matter, may contemporary data, given some of the inconsistencies in the way in which allegations get docketed.[2] But the value of the research findings is not in their univariate distributions, but rather in their multivariate relationships, analyses of the way in which detection strategies and differential access are related to the nature, characteristics, and vulnerabilities of behavior. And, at the multivariate level, the potential unrepresentability of single distributions is much less problematic. What is

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[2]See Chapter 2.

essential is that full distributions on both independent and dependent variables be available within the aggregate of sample elements. If anything, the greater longitudinal scope of the research has helped ensure the diversity of elements in the sample. These historical data are fully appropriate, then, for the multivariate analyses on which the dissertation is based.

It is appropriate to go even one step further with respect to the generalizability of these findings. Not only are they relevant to contemporary inquiries about the enforcement work of the SEC, they are relevant to other social control contexts as well. One of the rationales for selecting the SEC as a research setting was the tremendous diversity of offenses over which the agency has jurisdiction and the considerable range of alternatives in its intelligence repertoire.

Virtually every detection strategy found in that repertoire can be found in other contexts as well. Even market surveillance, a strategy seemingly peculiar to securities enforcement, is found elsewhere. James Rule (1974) describes the surveillance apparatus of the BankAmericard system, in which computerized transaction records are scrutinized to make inferences about potential fraudulent credit card use, a process remarkably similar to market surveillance. And, clearly, the range of variability in offense and offender characteristics, of behavioral vulnerabilities, in securities violations are found in other kinds of offenses as well, particularly of the white collar variety. Other offenses tend to generate snatches of observable behavior and behavioral artifacts, particularly in the form of records. And they also tend to be surrounded by layers of participants, customers, collaborators, victims, and other proximate audiences to which information can be diffused and which can similarly render these offenses vulnerable. Hence, insights about the relationship between intelligence and behavior derived from the study of the SEC are clearly relevant

to analyses located in other settings.

Offense Correlates of Detection Strategy

Because securities violations are so disparate, not only with respect to their substantive characteristics, but in the complex details of their execution as well, it is not surprising that they cannot all be detected in similar fashion. Indeed, perhaps the most important finding of the dissertation is that only by pursuing varied intelligence strategies, can the SEC accumulate a more representative sample of offenses. Some detection methods are more versatile in the range of offenses they uncover than others, but no single method or small set of methods can uncover them all.

This message is conveyed repeatedly throughout Chapters 6 and 7. Figure 7.1, which abstracted offense specific detection patterns, reproduced here as Table 8.1, conveys this message with respect to substantive characteristics of offenses. Each of the four patterns aggregates detection strategies that, with respect to substantive violation, uncover similar kinds of illegality. This figure is perhaps the simplest yet most dramatic confirmation of the ideas that animated this research. The way in which one attempts to detect illegality is indeed related to the output of the intelligence process.

It is clear from Table 8.1 that, were the SEC to rely on only a single type of intelligence or a limited number of them, it would be unable to detect the full range of offenses over which it has enforcement jurisdiction. Detection strategies especially suited to uncovering technical violations (pattern 1) are not the same ones suited to discovering securities frauds (patterns 2-4). And among those strategies most likely to uncover securities frauds, those suited to detecting not at all apparent offenses like stock manipulation and self-dealing (pattern 2) are not the same as those likely to uncover the more apparent offense of misappropriation (pattern 4).

TABLE 8.1: DETECTION SPECIFIC OFFENSE PATTERNS

% ACROSS	None	Technical Violations Only	Registration Violations Only	Misrepresentations Only	Registration Violations and Misrepresentations	Misappropriations Only	Registration Violations, Misrepresentations, and Misappropriations	Manipulation, Self-Dealing	TOTAL
PATTERN 1									
(2) Filings	0 0%	55 57%	2 2%	11 12%	8 8%	1 1%	6 6%	13 14%	96
(3) Self-Disclosures	0 0%	5 24%	4 19%	3 14%	2 10%	1 5%	3 14%	3 14%	21
(6) Self-Regulatory Agencies	0 0%	12 26%	6 13%	4 8%	7 15%	5 11%	7 15%	6 13%	47
PATTERN 2									
(1) Market Surveillance	0 0%	0 0%	0 0%	1 4%	0 0%	0 0%	0 0%	21 95%	22
(2) Spin-offs	1 2%	3 7%	6 15%	2 5%	5 12%	4 10%	6 15%	14 34%	41
(5) Informants	0 0%	2 9%	2 9%	1 4%	2 9%	3 14%	2 9%	10 45%	22
PATTERN 3									
(1) Other Surveillance	0 0%	0 0%	4 12%	3 9%	13 38%	0 0%	5 15%	9 26%	34
(4) Actual Investors	1 1%	1 1%	10 10%	9 9%	19 16%	17 16%	26 25%	22 21%	105
(4) Solicited Investors	0 0%	1 3%	5 16%	4 12%	10 31%	2 6%	7 22%	3 9%	32
(5) Professionals	1 4%	1 4%	0 0%	1 4%	11 39%	0 0%	7 25%	7 25%	28
(6) Federal Agencies	0 0%	0 0%	3 12%	4 16%	4 16%	1 4%	7 28%	6 24%	25
(6) State Agencies	0 0%	0 0%	8 14%	6 10%	18 30%	4 7%	11 19%	12 20%	59
PATTERN 4									
(3) Participating Insiders	0 0%	0 0%	0 0%	2 13%	3 20%	3 20%	5 33%	2 13%	15
(3) Employers	0 0%	0 0%	0 0%	0 0%	0 0%	2 50%	1 25%	1 25%	4
(4) Actual Investors	1 1%	1 1%	10 10%	9 9%	19 18%	17 16%	26 25%	22 21%	105
(2) Inspections	0 0%	8 22%	1 3%	2 5%	6 16%	8 22%	4 11%	8 22%	37

These detection strategies pattern themselves with respect to non-substantive aspects of securities violations as well. The likelihood that non-registered offenders, stock issuers as opposed to stock brokers, offenses with substantial victimization, "fresher" offenses of shorter duration, and the like will be detected all vary by detection method. For example, both other surveillance and state agencies are classified in pattern 3; both are most likely to uncover offenses based on registration violations and misrepresentation. But, in almost every other way, the offenses they detect are different. Relative to state agency referrals, offenses uncovered by non-market surveillance are substantially more likely to pertain to broker-dealers, to involve more organizations, larger organizations, larger numbers of offenders, more substantial victimization and monetary impact, and to be of shorter duration. Although constructing an intelligence system around either non-market surveillance or state referrals may make no difference with respect to the substantive offenses detected, it would make a substantial difference with respect to other qualities of these offenses.

Qualitative differences of this kind could be found among other detection strategies classified in the same substantive offense category. These differences do not suggest that one strategy discovers "better" offenses than others. Indeed, no single detection method is clearly most stellar in the significance of the offenses it uncovers. Rather, a number of strategies each generates the most significant offenses in the sample. And these offenses are often significant for different reasons - because of the substantive offense, the extent of victimization, the scope of offender constellations. In short, in order to assemble an investigative pool that represents some of the most significant offenses and the full range of offenses and offenders over which the SEC has enforcement responsibility, it is necessary to strive for balance in

intelligence strategies, not exclusivity.

These findings are absolutely consistent with the theoretical ideas developed in Chapter 1. Successful intelligence must exploit the vulnerabilities in illegal activity. And vulnerabilities are not distributed equally across offenses. Such factors as the number of offenders; their relationship to investors, to the SEC, and to other offenders; the media of their communications and transactions; the use of cover-up techniques and other devices to render activities less apparent and more subtle; each generates differing numbers, constellations, and timings of vulnerabilities. And, therefore, particular detection methods are more likely to encounter certain offenses than are others.

These ideas are exemplified by one of the most interesting contrasts of the dissertation, between surveillance and referrals by investors. Table 8.2 recapitulates the most important of the dimensions on which they are compared. As indicated in the table, investors and surveillance are similar in a number of respects. The offenses they detect are of relatively equal significance (31% are judged very significant), and they are very similar in the extent to which they contain the generic elements of registration violations (62% for investors, 58% for surveillance) and misrepresentation (79% investors, 82% surveillance) and in the extent to which they generate victims (87% investors, 82% surveillance).

But it is at this point that these two detection strategies diverge. On a number of more refined criteria, the "catch" of these strategies are as different as they might be. Investors are much more likely to refer the apparent offense of misappropriation; surveillance methods are much more likely to uncover the substantially less apparent stock manipulation and self-dealing schemes. Misappropriations are micro-events; they may inhere in a single

TABLE 8.2: DIFFERENCES IN OFFENSE CORRELATES - INVESTORS VS. SURVEILLANCE

	Investors	Surveillance	Total
TYPE OF OFFENSE			
% Registration Violations	62%	58%	50%
% Misrepresentations	79%	82%	66%
% Misappropriations	48%	26%	29%
% Stock Manipulation	6%	33%	10%
% Self-Dealing	15%	36%	13%
MEDIA OF OFFENSE			
% Oral Statements	63%	38%	42%
% Press	12%	34%	10%
% Market Data	1%	7%	3%
VICTIMIZATION			
% No Victims	13%	18%	36%
% Victims and Offenders - Strangers	44%	72%	41%
MAGNITUDE OF OFFENSE			
Ratio Large/Small Organizations	0.49	1.50	0.48
% More Than 1 Organization	25%	44%	22%
% More Than $100,000	35%	50%	31%
% More Than 100 Victims	31%	50%	28%
% VERY SIGNIFICANT	31%	31%	20%

embodied transaction. Stock manipulation is a macro-event; it leaves accessible, public residues. Investors refer offenses, a large proportion of which were executed by means of oral communications in embodied interactions. Offenses uncovered by surveillance are substantially more likely to have been executed by means of public vehicles like the press and the stock market. The catch of investor strategies tend to be smaller transactions consummated by embodied interactions. But these offenses are invisible to surveillance; instead it detects offenses enacted by means of wide dissemination of information and public communicative media. By virtue of their embodied communications, offenders and victims are likely to have been acquainted in investor referred cases; in surveillance offenses, they are most likely to remain strangers.

As offenses increase in scope, they become more visible to surveillance methods, with only peripheral access to settings of illegality. As a result, the catch of surveillance methods are more likely to pertain to large-scale organizations, to multiple organizational offenders, and to offenses with substantial economic magnitude and substantial numbers of victims, relative to that of investors. For investors, with much direct access to illegality, increasing offense scope is associated with characteristics that render them unwitting or at least unwilling to complain.

These differences between surveillance and investor cases are substantial. As noted in Table 8.2, percentage differences are mostly around twenty-five percent. What they suggest is a distinction between macro and micro offenses, based upon the amount of face-to-face contact between offenders and victims, the numbers and magnitudes of transactions, the extent to which they leave public residues, and the complexity and size of offender constellations. Surveillance detects macro offenses because, by virtue of their vulnerabilities - of more

diffused and public information and residues, of more observable transactions - they are the only offenses perceptible to surveillance methods that lack any access to the settings of illegal activities.

This contrast is mirrored, though less dramatically, in that between referrals from the securities community (akin to surveillance) and those from participating insiders (akin to investors). Participating insiders have clear and substantial access to the illegal activities in which they participate. Members of the securities community are excluded from illicit transactions and activities. From their peripheral locations, they learn of offenses only when information and residues diffuse from the setting of illegal activities. Members of the securities community are more likely to refer macro offenses, because, typically, only offenses of substantial magnitude have vulnerabilities perceptible to these unaffiliated outsiders.

Expanding Intelligence Technologies

As previous discussion has made abundantly clear, an intelligence system should seek balance rather than exclusive emphasis on a limited number of detection strategies, if a full and heterogeneous pool of investigations is to be generated. It is only in such a fashion that the diverse group of vulnerabilities that attach themselves to deviant behavior can be exploited. The choice of any detection method involves trade offs - between greater access to illegality and loss of perspective, between spontaneity and inaccuracy, and so on. In order to balance trade offs, strategies may be balanced as well.

But the fact that the analysis would suggest that no detection strategies be dropped, does not necessarily imply that these existing strategies are adequate or creatively implemented, or that there are no additional detection strategies that would make important contributions to SEC intelligence. Both of these possibilities are considered below. Generally, we ask whether deviant

behaviors can be made more vulnerable or whether intelligence efforts can be redesigned to better exploit new or existing vulnerabilities. The focus here is on changes that have implications for intelligence, not changes that are designed to lower the incidence of lawbreaking. Although the latter concern is clearly an important one, it is unrelated to the data and analysis presented in the dissertation, and is therefore unlikely to benefit from their insights.

Improving Existing Strategies

Insider disclosures. Much has been said in previous chapters about the wealth of intelligence available to insiders and the dearth of occasions on which it is shared with the SEC. One possible improvement in intelligence policy, then, would be to increase the opportunities and incentives for insider reporting. Of all the detection strategies, concern for improving insiders as intelligence sources has received perhaps the most attention, both within and outside of the SEC. One proposed reform, best elaborated in the work of Christopher Stone (1975) pertains to changes in corporate governance, expanding the responsibilities and accountability of corporate boards of directors, increasing the representation of the public in the choice of outside directors, and the like. One intended consequence of such reforms would be the greater dissemination of information both within and without public corporations and greater responsibility in disclosures to the SEC and to the public.

A variation on this theme, which has met with some success, is the creation of special audit committees, composed usually of outsiders, whose responsibility is to investigate and report on violations of law and other improper or questionable conduct engaged in by corporate personnel.[3] Many of these special

[3]See McCloy (1975), one of the earliest and finest reports generated by special audits of this kind, in this case, that of the participation of Gulf Oil Corporation in domestic and international bribery.

audit committees have been created as a result of terms of settlement of SEC consent injunctions, and their reports subsequently filed with the federal district courts. One proposal for intelligence reform might be to make special audit reports of this kind mandatory for all public corporations irrespective of their "law enforcement record." Just as public corporations must expend considerable funds for annual financial audits by outside accounting firms, so it could be required that similar "deviance" audits be performed as well. Obviously, the costs, both in money and in staff time, and the disruption incurred by such audits would be considerable and should be weighed seriously before implementing a reform of this kind. Furthermore, before such a program is implemented, research is needed to evaluate the impediments to accurate appraisals by outsiders, the likelihood that such outside auditors would become corrupted, and the like.

A second kind of reform, implemented to some extent in recent years and designed to insure better conduct as well as better disclosures by insiders, is based on expanding allegations of culpability - making additional actors and additional corporate positions culpable for acts which traditionally involved charges against only a smaller number of direct participants with responsibility for violations. For example, corporate officers, directors, or managerial personnel may be declared culpable for the illicit acts of their employees, regardless of the evidence of their direct responsibility or even knowledge of these acts.

Another attempt at expanding notions of culpability is reflected in the SEC "access points" theory, described earlier in the dissertation. Extending culpability up the corporate hierarchy to officers, directors, and managers, represents a vertical approach to culpability. The access points theory represents a horizontal approach, of extending culpability to collaborators,

co-participants, facilitators, directly or indirectly engaged in or aware of illegal activities. With the access points theory, the SEC has focussed on expanding culpability to securities professionals, attorneys, and accountants who often provide the access necessary for illegalities to be executed. But there is no practical reason not to expand culpability to other collaborators as well - brokers, bankers, printers, "bird dogs," journalists, and the like. At present, there are some moral and some legal issues, both considered shortly, against expansions of this kind, but, clearly, they should result in increasing levels of disclosure (as well, most likely, of retarding rates of collaboration).

Another alternative is to redesign disclosure incentives among those clearly culpable - to engineer rewards and punishments in such a way that an insider runs considerable risk by not disclosing information to the SEC. The major existing attempt of this kind is a rather unelaborate one, found in the SEC's "voluntary program," connected with the international bribery and questionable payments inquiries (U.S. Securities and Exchange Commission 1976, Kennedy and Simon 1978). In this instance, the SEC created a voluntary disclosure program, in which corporations were requested to come forward voluntarily and disclose information about illegal and questionable payments they made. Four hundred companies ultimately cooperated (Kennedy and Simon 1978, p.1). The disclosure incentives for these acts were that deviance confessed voluntarily would not be punished or would be punished more leniently than that which the SEC might discover without voluntary cooperation. In this particular case, the most serious deviance was the initial non-disclosure itself, in that public corporations are required by the securities laws to disclose to shareholders material events, including illegal ones.

However, attempts at inducing insider disclosures can be more creative than

the so-called "voluntary program." First, social control agencies can attempt to engineer discord, suspicion, and decreased solidarity among insider groups. As described earlier in the dissertation, M. A. P. Willmer, in his Crime and Information Theory (1970, pp. 84-85), suggested that police officers sometimes exaggerate estimates of the size of a robbery or disclose false information to the press to make individual insiders suspect that they have been double-crossed. This engineered disintegration as an art form was illustrated in the television series "Mission Impossible," presented a few years ago, in which agents would go about the business usually of toppling foreign governments or aspiring dictators by manipulating reality in such a way as to induce insider disloyalty of some kind. Whether these elaborate fictional scenarios portray the actual activities of the FBI, CIA, KGB, or other domestic or foreign government agencies is, of course, an open question.

Efforts of this kind are designed primarily to manipulate disclosure incentives. Here we have much to learn from game theorists, and their analyses of individual decision-making in light of manipulated contingencies. The general game context appropriate here is one in which, if there are no insider disclosures and offenses are never discovered, the rewards to all insiders are highest, but if there is one disclosure, the punishments to all insiders save the disloyal one are very severe, even more severe than if the offense is detected by other means. And so, given this scenario, insiders must then contemplate their future actions, given varying reward and punishment structures. In the social control context, negotiations over plea bargaining and turning state's evidence, etc. are and may be even more carefully manipulated with this aim in mind.

It is noteworthy that the latter kinds of manipulations of disclosure incentives do not assume that social control agencies have knowledge or

suspicions of the location of illegal activities. The former strategies, attempts to manipulate insider loyalties à la "Mission Impossible," may require considerable information by manipulators concerning these illegal settings.

Most of these reform ideas involve the manipulation of positive and negative disclosure incentives mixed with an occasional manipulation of reality, of con gamesmanship. One additional positive incentive may be necessary for insider disclosure schemes to work. The use of plea bargaining and other contrivances of prosecutorial discretion may help to protect culpable insiders who disclose information. However, there are few protections for the non-culpable insiders who disclose information, the "whistle-blowers." It may be necessary to protect whistle-blowers in the private sector as they are in the public sector. These efforts may include requirements that organizations named in or convicted of securities violations keep whistle-blowers on the payroll at comparable or higher predisclosure levels of compensation, or, more realistically, given problems of ostracism, vengeance, and the like, requirements that government employment be promised to private whistle-blowers whose allegations lead to civil, criminal, or administrative proceedings. It is unlikely that extreme forms of protection of the kind given to government witnesses in organized crime cases, involving the assignments of new identities and assistance in relocation and the building of new lives will be necessary. But, sensitivity to the substantial social costs of disclosure is necessary if programs designed to increase insider reporting are to be successful.

Referrals from other social control agencies. Looking back to Chapters 5-7, two of the more surprising findings pertained to rates of referral from other social control agencies and the composition of offenses so referred. With respect to the former, the extremely low rate of referral from federal and certain self-regulatory agencies was noteworthy; with respect to the latter, the

rather innocuous character of offenses referred by self-regulatory agencies (relative, for example, to state referrals) was apparent. The policy issue, then, is how rates of referral from other social control agencies can be increased and the quality of the offenses referred be improved.

Proposals to reform insider disclosures pertained mostly to engineering positive and negative disclosure incentives. Similar reforms could apply to other social control agencies as well, for example, providing assistance or support in their enforcement efforts as positive disclosure incentives, threatening self-regulatory agencies with withdrawal of their SEC registration if referral efforts do not improve, as negative disclosure incentives. But, more realistically, attempts to facilitate reporting rather than inducing it may be more effective. Facilitation could pertain to two issues, educating other agency personnel to sensitize them to potential securities violations and improving channels of communication through which disclosures can be made.

I have seen examples of both such facilitation efforts in my research at the SEC. Officials from federal, state, and international agencies are invited to attend the SEC's week-long Enforcement Training Conference, designed primarily for new SEC staff, where they learn about the securities laws, strategies of detecting, investigating, and prosecuting offenses, SEC investigative resources, and are even trained in introductory accounting, strategies of interrogating witnesses, and the like. Participation in the Conference also creates acquaintanceship networks that can later be exploited for intelligence purposes. The educational contributions are invaluable. Perhaps were other agencies encouraged to participate in greater numbers than they have so far (perhaps with some funding), the impact might be substantial.

I learned of a second effort toward facilitating referrals from other social control agencies in the course of the archival research. It pertained to

multi-jurisdictional enforcement conferences in various regions, in which information and expertise were shared among government and self-regulatory enforcement personnel. It may be valuable to institutionalize such conferences at the regional level, include more diverse enforcement roles - U.S. Attorneys, local district attorneys, FBI and IRS personnel, state regulatory officials, self-regulatory and private social control agencies, and the like - as well as some of the newer white collar crime enforcement teams (for example, The Economic Crime Project of the National Association of District Attorneys). In short, improved education and communication should enhance the intelligence contribution of outside social control agencies.

Investors. As previous analyses have demonstrated, investors are substantial investigative sources. However, their intelligence roles could be improved in several ways: by making unwitting investors witting, by increasing disclosure incentives, and by transforming actual investors into solicited investors. As analyses in Chapter 7 suggested, there are real advantages to receiving disclosures from solicited instead of actual investors. At the personal level, the solicited investor is less likely to have been victimized than if he waits to contact the SEC only after making an investment. At the aggregate level, disclosures from solicited investors generally come much earlier in offense history than do those from actual victims. Hence, with much earlier intelligence, the SEC is able to intervene and halt illegal activities before significant harm is done.

How, then, can actual investors be transformed into solicited investors? The simplest answer is by creating in the securities industry the kind of consumer movement found in other industries. Many middle class consumers would not think of buying a major appliance without first checking Consumer Reports or some other source. Why should not investors, who may commit substantially more

money to their stocks than they do to their refrigerators and vacuum cleaners, not be intelligent consumers as well? Take one example:

> Many banks now have computer terminals with which account holders can verify account information, even deposit and withdraw money. Why not add to computer memories lists of all securities registered with the SEC (including limited issuances registered under Reg A)? The investor goes into the bank to secure financing for his investment. He types the name of the issuer into the terminal. On the terminal, one of two responses is displayed: (a) "The issuer is registered with the SEC." And information about how the investor may secure copies of prospectuses, annual reports, 8K reports, etc. is provided. (b) "The issuer is not registered with the SEC, which may be because the offering is intra-state,[4] is very small scale, or because it is fraudulent. The investor should therefore be especially cautious before committing any money. Furthermore, the SEC would appreciate it if the potential investor would type his name and address into the terminal so that SEC investigators may contact him and secure information on the contemplated investment." Of course, such cooperation is not mandatory, but even if investors don't comply, the agency at least gets a record of the names of potential illicit stock offerings in a particular area.

Given the fact that so many fraudulent schemes in the sample were coupled with registration violations, just evaluating stock offerings with respect to registration status may be extremely valuable. This computer terminal idea is relatively simple, yet it may have the effect of protecting investors, or at least of generating solicited investor rather than actual investor intelligence.

How about the actual investors who have committed money in particular securities, whether or not registered with the SEC, for whom it is too late to be converted to solicited investors? I am aware of current efforts by SEC staff to educate consumers. These efforts may be expanded. Perhaps all registered broker-dealers and issuers could be required at the time of investment and with every proxy statement to provide to investors informational packets developed by

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[4]State securities commissions might also add their registrants to computer memories as well.

the SEC. These materials would attempt to educate investors with respect to clues or tell-tale signs of various kinds of securites violations to help reduce the likelihood that they will remain unwitting.

Investor disclosure incentives should most likely be positive rather than negative. The positive incentives inhere in attempts to demonstrate to investors that the SEC is protecting them, is responsive to their needs, is not coopted by the industry, that investigative outcomes may be strong SEC enforcement cases that may result in restitution or on which their own private derivative suits or other civil suits may be based. Increasing positive incentives in the absence of educational efforts or of the provision of simpler means of communication with SEC enforcers are unlikely to be successful, however.

Finally, it is becoming increasing true that investors are more likely to be institutional groups rather than single individuals. Where this is the case, the resources and incentives to be witting and to carefully scrutinize investments are much higher. Efforts to help educate and to facilitate mutual cooperation among institutional investors may have significant intelligence fall-out as well.

Spin-offs. Another of the surprises of the dissertation research was the infrequency of investigations that were spun-off from previous investigative efforts.[5] Either my assumptions that offenders recidivate and/or "birds of a feather flock together" are wrong, or else SEC officials are not sufficiently milking ongoing investigations for their intelligence insights.

Offenses investigated should be thought of as tips of the iceberg, and investigative activity should attempt in every way to uncover more of this

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[5]One explanation for this fact is based on idiosyncracies of docketing practices, but it is at best only a minor and partial explanation.

iceberg. Every link in an offense should be pursued with questions like whether principals have engaged in or are engaging in any previous, simultaneous, or subsequent illegal activities; whether collaborators or facilitators, whatever their culpability, have engaged in or are involved in other offenses; whether witnesses have access to other unrelated information; whether victims are currently investors in any other questionable securities.

Securities violators should be routinely followed up to check on possible recidivism. Perhaps, as part of a settlement to a consent decree, offenders might be routinely required to perform periodic special audits (described above), one function of which would be to uncover any additional unrelated violations. In short, ongoing investigations appear to be enormously valuable intelligence resources. Spin-offs should no longer be haphazard or fortuitous. Rather, there should be regular procedures for follow-up on investigations and on the parties that are included therein, for more systematic reliance on spin-offs as intelligence sources.

The securities community. The data derived from this research suggest that referrals from members of the securities community concern some of the most significant offenses in the sample and some of the most subtle offenses, unlikely to be disclosed by other parties. Yet, members of the securities community are among the most unlikely investigative sources. Because parties in these roles generally have little involvement or interest in these offenses, it is difficult to devise positive or negative incentives that would be just or appropriate.[6] Of course, bounty or reward systems for information on securities violations could be instituted, but it is unclear whether incentives of this

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[6]The possibility that some non-culpable brokers may become civilly liable for bad investments which they advised their clients to make or the possibility that they too may be victimized as a result of their participation in these transactions, may induce them to cooperate with the SEC in special circumstances.

kind would be effective in inducing disclosures from professionals.

Given some skepticism about the success of providing disclosure inducements to members of the securities community, more realistic efforts to facilitate disclosure may pertain to setting up lines of communication and education rather than, to incentives.

A first step is educational, alerting members of the securities community to the kinds of offenses they may encounter and to the tell-tale signs of violations for which they should look. Responsibility for training orthodox securities professionals - brokers, accountants, investment advisors - could be given to self-regulatory organizations. Bar associations may be induced to train attorneys. Informal educational meetings may be set up with more unorthodox members of the surrounding community - bankers, the telephone company, landlords in the financial district, journalists, financial printers. For example, SEC representatives must have met with telephone company personnel in one of the regions, because a few of their boiler room cases in the sample were generated by referrals from the phone company - alleging excessive orders for telephone lines or widely fluctuating long-distance charges by particular brokerage firms.

Part of the educational process would include the development of lines of communication across which intelligence might flow. With respect to securities professionals, they could be required to keep files of questionable literature and solicitations they have received which might then be examined during broker-dealer and investment advisor inspections. Although brokers and investment advisors could be sanctioned for not maintaining such files, there is no way of insuring that they maintain them conscientiously. Still, it is a start.

I am relatively pessimistic about the impact of efforts of this kind on the

rates and quality of referrals from the securities community to the SEC. However, given the apparent quality of the referrals they do make, some creative reformation of disclosure incentives and communicative mechanisms is clearly appropriate.

Non-market surveillance. Like referrals from the securities community, cases detected by "other" or "non-market" surveillance were among the most significant in the sample. Although substantively, they resembled offenses generated by reactive detection strategies, especially investor complaints, these cases were in other respects quite distinctive. These illegalities were, in the language of an earlier section, "macro-offenses;" they were big in the constellation of offenders, in their economic impact, and in their victimization. Furthermore, the other surveillance strategies are much more likely than the reactive strategies to detect offenses early in their development; they are better able to "nip offenses in the bud."

The description in Chapter 5 of the implementation of non-market surveillance strategies revealed essentially a system of accidental and fortuitous encounters that resulted in investigation - noticing a magazine ad while waiting in a barber shop or a promotional brochure while waiting for prescriptions at a drug counter. Given the quality of the cases so generated, it seems sensible to better organize these practices. Perhaps each regional office could designate one or two surveillance officers and the Enforcement Division of the Headquarters Office could create a special "non-market" surveillance branch. Surveillance officers would be responsible for scouring the local press, examining trade publications, records of civil, criminal, and bankruptcy litigation that pertains to securities issuers and their personnel, routinely meeting with other regulators and law enforcement officials, bankers, members of the securities bar, members of the securities professions,

journalists, etc. to discuss potential problems in the industry. If the SEC decided to engage in undercover work (described below), surveillance officers would be responsible for its implementation as well. However this task becomes organized, it is clear that if surveillance efforts are to uncover matters different from the catch of market surveillance and other incursive strategies, they must focus primarily on entities not registered with the SEC.

This list of existing intelligence strategies does not cover the whole set of detection strategies in force. However, it includes those strategies generating the most significant cases and those strategies that seem most amenable to reform. However, there may be additional technological improvements in intelligence systems that are not based upon existing strategies. They are considered in the following section.

Creating New Intelligence Technologies

As this chapter is being written, a new domestic scandal is breaking, billed as the "biggest since Watergate," generated by the FBI ABSCAM investigations. The investigation concerns allegations that public officials accepted substantial bribes in exchange for promising favors to wealthy (fictitious) Arab businessmen. The investigation was based upon a "sting" operation in which the FBI set up a house in Georgetown with videotape equipment and sent its agents under cover as representatives of the Arab businessmen to offer bribes to American politicians. Through the ABSCAM investigations, the FBI is bringing some of the techniques of vice work and other street crime enforcement to the intelligence of white collar crimes.

The use of these undercover techniques and covert observational methods in the investigation of white collar crime suggests that their role in securities enforcement be entertained. To my knowledge, SEC personnel never utilize

techniques of this kind in investigative activity. Is this for ethical reasons, because SEC attorneys and the potential objects of their investigative work are too respectable to engage in techniques of this kind, or because undercover work is not well suited for securities investigation? The last interpretation is probably most accurate. In most cases, securities investigations do not require undercover tactics.

Both the ABSCAM types of bribery and corruption and traditional forms of vice are victimless or consensual crimes. They are difficult to detect because there are no complaining victims. Few securities offenses are victimless or consensual; hence more intelligence alternatives are available. But what of the offenses which occur within a single organization and in which investors are unwitting, a con game, for example? Like prostitution and corruption, there would be no complaining victims in an offense of this kind. Would it be appropriate to send agents under cover to detect offenses with unwitting victims? The problem, of course, is where they would be sent. Unlike prostitution, for which most cities have red light districts, or bribery, in which there is a finite and enumerable set of public officials with power with respect to foreign affairs, most securities fraud is unorganized. It can emerge in any location, among any group of individuals, regardless of occupational position, on any social occasion. It is absolutely unclear where one should send undercover agents.[7] This harks back to the Reiss discussion, cited in Chapter 1, that where offenses are unorganized, it is difficult to mount a successful proactive enforcement program.

Hence, undercover investigative strategies can be implemented only where activities are organized or when one is able to predict the setting in which

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[7]It is also unclear what roles - victim, facilitator, offender roles - undercover personnel should play.

illegality is likely to occur. But even with this information, only a limited number of undercover roles are available. Suppose we suspect that officers of ABC Corporation are engaged in self-dealing. The SEC cannot simply send off one of its staff directing him to become a corporate insider with access to the highest level corporate decision making, the same way a police officer is sent out to play the role of a "John." Such entree would probably not be successful, and even if it were, it would most likely take years. The risks of non-promotion of SEC undercover investigators are at least as high as those which plague every aspiring upwardly mobile employee. It may, of course, be possible to secure lower level roles, but they may not be sufficiently proximate to learn of the activities of interest.

Perhaps the only realistic kind of entree would be in collusory or victim roles. If one desired to investigate stock issuers, one might go under cover as a brokerage firm or employee, or maybe as an interested investor. If one sought data on brokerage firms, one could masquerade as an investor or perhaps as an issuer (for example, seeking underwriting for a securities offering). Again, the problem of unorganized behavior and predictability emerges. One does not simply set up a brokerage firm in New York City and wait for the cases to fall in one's lap. One must have preestablished assumptions of the most likely loci of illicit behavior, rarely available for undetected securities frauds.

However, there may be particular industries or geographic areas in which offending may be quite likely and there is sufficient predictability to set up an effective undercover operation. For example, with the energy crisis, on the one hand, and the incredible overnight appreciation of value in precious metals, on the other hand, it is reasonable to assume some attempts at securities fraud in the sales of interests in oil wells or silver mines. In this instance, it might be profitable to send undercover brokers or promoters to Texas or the

Northwest United States. Here the likelihood of several attempts at securities fraud within a relative circumscribed area with a fairly stable cohort of offenders, might better insure successful intelligence efforts.

In most cases, however, the lack of predictability of the settings of salient offenses, coupled with the difficulty of securing access to viable undercover roles and the tremendous commitment of time, resources, and manpower to gather intelligence which might well be obtained in a much easier way, simply would not warrant detective strategies of this kind.

Limits on Intelligence: Legal and Moral Issues

Previous discussion considered some of the technical, organizational, and economic obstacles to reengineering intelligence systems. There are two additional obstacles. Technological changes of the kind proposed may violate or be inconsistent with extant law and/or they may be abhorrent to basic moral values.

With respect to the former, the legal impediments, there may simply be no legal support for some of the technological changes envisioned. For example, an important inducement upon which many of these proposed strategies are based is one of extending culpability for illegal activities to more and more peripheral collaborators or facilitators. But there may be insufficient legal or evidentiary support to allege culpability of this sort. For example, several of the SEC access point cases, which allege culpability primarily to attorneys and accountants, have been reversed in the courts (Hershey 1976). In one of the most famous of these cases, Ernst & Ernst V. Hochfelder, the court ruled that, in order to collect damages in a suit against the accounting firm for failing to discover fraud, it was necessary to demonstrate "scienter," evil intention to defraud, not simply negligence. It is true that the Hochfelder case did not directly involve the SEC, its definitions of culpability, or the enforcement

remedies it has available. Still, if the court demands demonstrations of "scienter" in charges against the facilitators of illegalities, it may be difficult for the SEC to threaten these parties with culpability as disclosure incentives where it is unlikely that "scienter" would be adequately demonstrated. It may be necessary, then, to change elements of the securities laws if their potential negative sanctions are to be manipulated for intelligence purposes.

Then, there may be moral obstacles to the implementation of technological intelligence reforms. Is it right to send agents under cover, to potentially entrap would-be offenders? Or, for that matter, is it ethical to plant bugs or tap the telephone of securities professionals - most likely excellent intelligence opportunities? A whole host of moral issues surround possible reforms of SEC intelligence systems. They seem more obscure because the SEC has rarely been guilty of moral excess. But the example of the scandals surrounding FBI and CIA intelligence highlights the many abuses and controversial questions that inhere in intelligence systems. What is the proper amount of privacy assured to persons, their activities, their transactions, their records? What is the proper degree of intrusiveness of government in people's lives; the extent to which persons can be manipulated, intimidated, or deceived; the justice of discretionary prosecution, of letting a guilty person go free simply in exchange for information? And there are more philosophical or ideological questions as well, of the extent to which citizens can be expected to pay for regulation, whether investors, corporations, shareholders, or professionals must bear the burden of paying for the costs of enforcement. All of these questions can only be resolved by expressions of the moral preferences of our citizenry, not through some pretentions about social science expertise (which is unable to make moral choices).

Intelligence and the Enforcement Process

The notion that the detection process provides a critical juncture for the operation of a system of social control, in that it defines the system's caseload, is an insight not unique to this dissertation. For example, in their study of a police morals detail, Skolnick and Woodworth (1967) wrote:

> Awareness of infraction is the foundation of any social control system. Whatever the system of normative standards, whether these are folkways or mores, crimes or rules, a transgression must somehow be observed and reported before sanctions can be applied. The potential efficiency of a social control system, therefore, varies directly with its capacity to observe or receive reports of transgressions...This idea may seem obvious, yet without exploring it, without analyzing the empirical relation between awareness and control, we shall be failing to examine some of the more serious problems and hidden consequences of control systems (pp. 99-100).

Leon Mayhew, in his study of anti-discrimination law enforcement, describes this phenomenon as that of "jurisdiction" or "access" to violation (1968, p. 16); Donald Black describes it as "mobilization" (1973). Although social control systems can employ a variety of public relations gimmicks in attempts to insure compliance with the law and to afford protection to the potential victims of law violation, the most visible and dramatic strategy is that of the detection, investigation, disposition, and sanctioning of law violations.

But the details of gathering an investigative caseload have implications for the likelihood that any one of a number of law enforcement purposes will be fulfilled. Investigative caseload can be utilized to insure general deterrence, to protect investors, to maintain the integrity of the market system, to define the leading edge of securities law enforcement, to announce a new area of future law enforcement priority, to display the most flagrant abuses in hopes of securing new legislation. Particularly where a flexible disposition system is available, whereby it is not necessary to prosecute or severely sanction all

investigated offenses (as that available to the SEC), investigative caseload can be utilized to convey all sorts of messages unrelated to a concern for adjudicating a single offense and punishing a specific lawbreaker.

I think that the SEC recognizes this fact, of the strategic role of caseload, more than do many other social control agencies. Some of the data from sociological research on other administrative agencies - the Massachusetts Commission Against Discrimination (Mayhew 1968), California's Industrial Accident Commission (Nonet 1969) - suggest that, over time, these agencies tend to become coopted by the victims they are mandated to protect. The result is that they provide, in essence, a private-law system, a system in which law becomes trivialized, in which agencies ultimately become unable to institute strategic social change through their enforcement program. It is easy to understand how such a process could develop. With a constant and heavy imput of victim complaints, the agency gets settled into a reactive posture, of responding to the complaints, rather than exerting the much greater effort of mounting a proactive intelligence system.

I cite this example because, for the SEC, this process has been reversed. Over time, the agency has relied less and less on investor complaints to define its caseload. Especially in recent years, the agency has taken more intelligence initiative, developed better proactive strategies, gone after new categories of law violators. The result is that, while many administrative agencies demonstrate an increasingly trivialized caseload as they age, that of the SEC is becoming increasingly <u>less</u> trivial. This impression is clear, not only from all the public rhetoric that characterizes the SEC. It is also absolutely clear from the twenty-five year perspective on SEC history I have acquired from the experience of this research.

The point is that the attempt to realize any of the many and often

conflicting goals of law enforcement policy is an active and not a passive process. Agencies do not have to become coopted, they do not have to become captives of their reactive intelligence inputs. They always have the option of reengineering and rebalancing intelligence strategies in accordance with enforcement goals. Hopefully, this dissertation has provided some insight about the varying consequences of particular detection methods, insights invaluable in the development of intelligence programs that are consistent with enforcement policy.

APPENDIX A: CODING SCHEME AND MISSING DATA

	MISSING DATA
1. Docket # _____ (sample) _____ (earlier) _____ (earlier)	0%
2. Location of Investigation (4 MENTIONS)	0%
3. Date Case Opened	0%
4. Date Case Closed	0%
5. Date Investigation Initiated	12%
6. Date Investigation Completed	1%
7. Formal Order	0%
8. Date Coded	0%
9. Coding Time	0%
10. Case Magnitude	0%

01 New York	11 Cleveland
02 Boston	12 Los Angeles
03 Atlanta	13 Detroit
04 Chicago	14 Minneapolis
05 Ft. Worth	15 St. Louis
06 Denver	16 Tulsa
07 San Francisco	17 St. Lake City
08 Seattle	18 Houston
09 Washington Regional	19 Miami
10 Home Office	

Not requested	000000
Requested, not obtained	888888
Date obtained	_____
Other	888889
DK date	999999

0 0 - 30 minutes	5 2 - 3 hours
1 31 - 45 minutes	6 4 - 5 hours
2 46 - 1 hour	7 4 - 5 hours
3 1 - 1-1/2 hours	8 5+ hours
4 1-1/2 - 2 hours	9 DK

1. Extension of another case, formality
2. Minor, trivial
3. Average
4. Greater than average, significant
5. Tremendous
9. DK

MISSING DATA

11. Source of Investigation (and dates) (6 MENTIONS)

(source) _____ _____ _____ _____ 12%
(date) _____ _____ _____ _____ 13%

01 Referrals from Government Agencies/Parties
02 FTC
03 IRS
04 FBI
05 Other Justice Dept.
06 Post Office
07 Other Regulatory Agency
08 President/Executive
09 Congressman/Legislative
10 State Securities Commission
11 Other State Regulatory Agency or Local
12 Foreign Securities or Regulatory Agency
19 Other
20 Referrals from Self-Regulatory Agency
21 Stock Exchange
22 National Association of Securities Dealers
23 Securities Investors Protection Corporation
24 Better Business Bureau
29 Other Self-Regulatory Agency
30 "Complainant"
31 Victim
32 Victim's Lawyer
33 Victimized Corporation
34 Prospective Buyer, Solicited Party, Inquiry
35 Broker/Dealer
36 Investment Advisor
37 Other Securities-Related Professional
38 Outside Lawyer
39 Inside Lawyer
40 Outside Accountant (not related to audit)
41 Inside Accountant (not related to audit)
42 Corporate Director
43 Employer
44 Employee
45 Corporate Insider
46 Corporate Insider (party to illegality)
47 Competitor
48 Journalist
49 SEC staff or ex-staff as private persons
50 Anonymous
51 Other Informant
52 Complainant (DK identity)
53 Prospective seller
54 Stockholder
59 Other

MISSING DATA

60 Market Surveillance
61 SEC
62 Stock Exchange
63 Inspection/Audit
64 SEC
65 National Association of Securities Dealers
66 Other Private Agency
67 Accounting Firm
68 Special Audit
69 Routine Non-Filing, Delinquent Filing
70 Generated from other investigations - nonunique case
71 Generated from other investigations - unique case
72 Filing for registration or withdrawal of registration
73 Reg A filing, or other exemption
74 Reg A followup
75 Other Routine Disclosure
76 Self-Disclosure
77 Special Program
78 Press, Media, Advertising
80 Miscellaneous
81 Other Social Control (not a referral)
82 Proxy Fights
83 Bankruptcies
84 Securities Violation Bulletin
85 Mail cover, phone records, phone company referral
98 Other
99 DK

12. Number of Complainants 4%

0 None
1 One
2 Two
3 Three
4 Four
5 Five
6 6 - 10
7 11 - 20
8 More than 20
9 DK

MISSING DATA

13. Region of Complainants 5%

00	NA	16	Tulsa
01	New York	17	St. Lake City
02	Boston	18	Houston
03	Atlanta	19	Miami
04	Chicago	20	Philadelphia
05	Ft. Worth	21	Other
06	Denver	30	East Coast
07	San Francisco	31	West Coast
08	Seattle	32	South
09	Washington Regional	33	Midwest
10	Home Office	34	National
11	Cleveland	35	Southwest
12	Los Angeles	36	Canada
13	Detroit	37	Mexico
14	Minneapolis	99	DK
15	St. Louis		

14. Nature of Allegation by Complainants (4 MENTIONS) 2%

(USE ILLEGALITY CODE - #20 - PLUS:)

801 Generally Seeking Information
802 Never Received Stock, Dividends, etc.
803 Lost Money on Investment
804 Embezzlement
805 Corporate Mismanagement
806 Boiler Room Treatment
807 Can't Locate Principals
808 Generally Fraud
809 Poor Financial Condition
810 Wants Money Back
811 Passing Along Information

OFFENSE

MISSING DATA

15. Statutory Violations — 0%

00 None of these
01 '33 - 5's
02 '33 - 17
03 '34 - 10(b) 10b-5
04 '34 - 15(c) 15(c)(1) 15c1-2
11 5 & 17
12 5 & 10
13 5 & 15
14 17 & 10
15 17 & 15
16 10 & 15
21 5 & 17 & 10
22 5 & 17 & 15
23 5 & 10 & 15
24 17 & 10 & 15
31 5 & 17 & 10 & 15

16. Delinquent Filing Case — 0%

0 No
1 Yes: '34 - 17(a) 17a-5
2 Yes: '34 - 13 (issuers)
8 Yes: other statutes

17. Other Statutory Violations (7 MENTIONS) — 0%

00 None
01 '33 - Reg A, 3b, Rule 253, 254, 261
02 '33 - 5(b)
03 '33 - 3(b)
04 '33 - 24
05 '33 - 19(a)
09 '34 - 7(c), Reg T
10 '34 - 8(c), 8c-1
11 '34 - 9
12 '34 - 14a, X-14
13 '34 - 14a-3
14 '34 - 14a-9
15 '34 - 13(a)
16 '34 - X-12B
17 '34 - 13(b)
21 '34 - 10b-6
29 '34 - 15(d)
30 '34 - 15
31 '34 - 15a
32 '34 - 15c1-5
33 '34 - 15c3-2
34 '34 - 15b
35 '34 - 15(b)(1)
36 '34 - 15b1-1
37 '34 - 15b3-1
38 '34 - 15(b)(8), 15b8-1
39 '34 - 15b-2
40 '34 - 15b-1
41 '34 - 15c
42 '34 - 15(c)(1)
43 '34 - 15c1-4
44 '34 - 15(c)(2)
45 '34 - 15c2-1
46 '34 - 15(c)(3)
47 '34 - 15c3-1
48 '34 - 15c1-6
49 '34 - 15c1-8
50 '34 - 15c2-4
51 '34 - 15(c)(5)
52 '34 - 16
53 '34 - 17a-3
54 '34 - 17a-4
55 '34 - 17a-5

MISSING DATA

56	'34 - 17a-11	73	IC - 8
57	'34 - 17	74	IC - 7
59	'34 - 20	75	IC - 48a
60	'34 - 32(a)	76	IC - 21a
61	IC - 15(a)(1)	77	IC - 30
62	IC - 22(d)	78	IC - 49
63	IC - 22(e)	79	IA - 204
64	IC - 17	80	IA - 205
65	IC - 13a(2)	81	IA - 206
66	IC - 17a(3)	82	IA - 207
67	IC - 17e(1)	83	IA - 208
68	IC - 20(a)	84	IA - 203
69	IC - 34(b)	85	IC - 3
70	IC - 37	97	2e
71	IC - 36	98	Other
72	IC - 7a	99	DK

18. Type of Case **0%**

0 No illegality
1 Technical violation
2 Nonregistration
3 White collar crime
4 Technical violation and nonregistration
5 Technical violation and white collar crime
6 Nonregistration and white collar crime
7 Technical violation, nonregistration, and white collar crime

19. Period of Illegality

Began: _____ **6%**

Ended: _____ **3%**

20. Illegality (25 MENTIONS) **0%**

000 None
100 Technical Violations
101 Delinquent Filings (reporting violations)
102 Bookkeeping Rules (record keeping)
103 Net Capital Violations
104 Improper Extension of Credit
105 Failure to Deliver Security (non-fraud)
106 Hypothecation Rules (non-fraud)
107 Exceed Reg A Limit
108 Other Filing Problems
109 Reg T Problems - use of securities as collateral for loans
110 Escrow account for Underwriter
111 Confirmation Rules
190 Other

200 Non-Registration (and related problems)
201 Of a security - general
202 Of a security - interstate
203 Of a security - public/private
204 Of a security - secondary distribution by insiders, promotional
205 Of a security - inadvertent, novel issue
207 Of a security - creating false impression it's exempt
221 Of a professional - general
222 Of a professional - inadvertent
223 Of a professional - intentional
231 Filing proxy materials
241 Premature solicitation, gun jumping
290 Other
300 General Misrepresentations and Omissions
310 About Corporate Entity (Issuer, B/D, IC, IA)
311 Financial condition, earnings, etc.
312 Ris s, soundness
313 General prospects, pending corporate actions, contracts, sales
314 Prospects pertaining to corporate organization - mergers, acquisitions
315 Important Developments (i.e. lawsuits)
316 Corporate structure - affiliates
317 Source of corporate assets
318 Actual resources, production capability
319 About one's investment, monetary contribution
320 Previous employment, principals, officers, directors, background, experience
321 Business operations (issuer)
322 Brokerage related business operations, financial condition
323 Questionable business operations, slush funds, bribes, payoffs, commissions, illegal campaign contributions
324 Remuneration of corporate officers
325 Identity of control persons
326 Beneficial interests, security holdings of insiders
327 Other management issues
328 Self-dealing by insiders
329 Interests of insiders in corporate transactions
330 Investment shams
331 Ponzi schemes
332 Pyramid schemes
333 Using investment funds to discharge indebtedness of prior investments
334 Shell corporations, spin-offs
335 Phony tax shelters
336 Advanced fee swindle, front money
339 General Puffing
340 Other

350 About Stock, Its Distribution, Its Market
351 Stock ownership, source of stock
352 Selling non-existant securities
353 Selling more securities than stated capitalization, than can be supplied
354 That it is registered with SEC, needs to be, or is exempt
355 That it is listed on a stock exchange, or will be
356 Kind of stock - i.e. unissued capital stock when it was privately owned
357 Other quality of stock - i.e. classes
358 Use of stock sale proceeds
359 About repayment of bonds, loan
360 About dividends, return on investment
361 Price - current (market value)
362 Price - future; that it would rise; good for a quick profit
363 Information about present distribution, underwriting plan
364 Information about number of shares offered, number outstanding
365 Not a bona fide public offering
366 About one's role in distribution - agent, principal, undisclosed underwriter
367 About one's role in transaction - broker, dealer, etc.
368 Trading while engaged in distribution (10b-6)
369 Profits and compensation to brokers and underwriters
370 Sales without inventory, short sales
371 About forthcoming stock issuance
372 Manipulation
373 Manipulation - wash sales
374 Manipulation - matched orders
375 Manipulation - painting the tape
376 Manipulation - putting bids in sheets to create facade of trading
377 About market for stock
378 Reason for wanting shares
379 Identity of purchasers, investors
380 About stock redemption, repurchase
381 That corporation is supervised by some regulatory agency
382 Unexplained price rise, etc.
383 Other
390 Other
400 About Form of Investment Advice
401 Touting, undisclosed compensation
402 Source of information (i.e. astrology)
403 Source of information (i.e. inside information, tipping)
490 Other

500 Embezzlement
501 Misappropriation of funds
502 Use of stock proceeds for personal living
503 Use of stock proceeds for plush offices, etc.
504 Conversion of customer stock and proceeds of sale, bucket shops
505 Transfer of personal indebtedness to corporation
506 Didn't hold customer's securities in safekeeping
507 Use of customer's stock as personal collateral
508 Failure to deliver securities (fraud)
509 Hypothecation (fraud)
511 Sending confirmations to persons who hadn't ordered, false confirmations
512 Abuse of discretionary accounts
513 Churning - for commissions
514 Other churning
515 Cross-trading
516 Inappropriate, excessive, multiple commissions
517 Charging excessive prices, markups
521 Failure to pay for securities
522 Loading and reloading
523 Won't honor repurchase or reexchange agreement
524 Pledging worthless stock as collateral
530 Other
540 Self-dealing
541 Conflicts of interest
542 Insider trading, tipping (self-dealing)
543 Kickbacks, commissions, bribery
544 Scalping - touting a stock to take advantage of market
545 Abuse of fiduciary duty
550 Other
590 Other
600 Malpractice/Improper Sales Techniques
601 Boiler room tactics
602 High pressure sales
603 Sell and switch tactics
604 Failure to consider suitability of stock for client
605 Inappropriate advice
606 Failure to obtain the best price
607 Failure to confirm
608 Selling without an offering circular, prospectus, failure to deliver
609 Employing known violators
610 Improper supervision
611 Failure to investigate stock
612 Failure to supervise, scrutinize, direct -- by director
613 Improper controls
614 Interpositioning
615 Parking
690 Other

MISSING DATA

700 Violations Related to Previous Social Control
701 Working while suspended
702 Violation of injunction, parole, suspension
703 Disclosure of previous social control
704 Previously working for firm subject to social control
790 Other
705 Creation of organization to bypass social control, front
706 Organized crime
990 Other
991 Stolen securites
999 DK

21. Magnitude of Illegality - $ 14%

00 None, NA
01 $100 or less
02 $101 - $500
03 $501 - $1000
04 $1001 - $2500
05 $2501 - $5000
06 $5001 - $10,000
07 $10,001 - $25,000
08 $25,001 - $100,000
09 $100,001 - $500,000
10 $500,001 - $1,000,000
11 $1,000,001 - $2,500,000
12 $2,500,000 +
97 "Victims" lost no money
98 "Victims" made money
99 DK

MISSING DATA

22. Media of Misrepresentation (6 MENTIONS) 3%

00 None, NA
01 Professional to Client Communication
02 Other Oral Communication
03 (Issuer): Prospectus type materials, solicitation letters
04 (Issuer): Reg A offering circular
05 (Issuer): Annual and other status reports, proxy material, financial statements
06 Special SEC applications or filings
07 Books and Records
08 Use of Nominees, Dummies, Fictitious Persons
09 Investment related literature, documents, opinion letters, correspondence, sales brochures
10 Advertising, public relations
11 Market data, tapes, quotes, etc. (manipulation)
12 Press
13 Props
14 Confirmations
88 Other
99 DK

23. Victimization 2%

1 No victims
2 No victims - technical violation
3 No victims - non-registration
4 No victims enumerable - fraud
5 Enumerable 'victims' - non-registration
6 Enumerable victims - fraud
7 Enumerable victims
8 Other
9 DK

INVESTIGATIVE TECHNIQUE

24. Interview Principals, Co-conspirators 3%

0 No
1 Yes
9 DK

	MISSING DATA
25. Interview Persons in Business Relationships	8%

0 No
1 Officers, Directors
2 Other Business Associates
3 Other Broker-Dealers Only
4 Mixed
5 Employees
6 Officers, Directors, Employees
7 Accountants, Attorneys, Broker-Dealers
8 Other
9 DK

26. Interview Investors, Customers	5%

0 No
1 Investor questionnaires
2 Investor interviews
3 Both
9 DK

27. Interview Other Victims	2%

0 No
2 Yes
9 DK

28. Retracing Stock Transactions, Check Brokerage Records	3%

0 No
1 Yes
9 DK

29. Check Corporate Books and Records, Minutes	6%

0 No
1 Yes, books and records
2 Yes, minutes
3 Yes, both
9 DK

30. Check Other Records (phone bills, credit card receipts, check stubs, etc.)	2%

0 No
1 Yes
2 Mail Cover
9 DK

31. Check Bank Records	4%

0 No
1 Yes
9 DK

	MISSING DATA
32. Check Tax Returns	3%
0 No 1 Yes 9 DK	
33. Check SEC Records and Filings	5%
0 No 1 Yes 9 DK	
34. Check Actual Allegations - i.e. engineeer	2%
0 No 1 Yes 8 Other Expert 9 DK	
35. Query Other Social Control Agencies	9%
0 No 1 Federal regulatory agency 2 State securities commission 3 State regulatory agency 4 Self-regulatory agency 5 Foreign agency 6 Mix 7 Receiver, trustee 8 Other 9 DK	
36. Rely on Previous Investigative Work	2%
0 No 1 Yes 9 DK	
37. Quiz	2%
0 No 1 Yes 9 DK	
38. Check Press, Media, Advertising, etc.	1%
0 No 1 Yes 9 DK	

DISPOSITION

	MISSING DATA
39. Prosecutorial Status	0%

0 No SEC initiated prosecution - no violation found
1 No SEC initiated prosecution - other reason
2 Civil action
3 Administrative proceeding
4 Criminal reference
5 Civil action and administrative proceeding
6 Civil action and criminal reference
7 Administrative proceeding and criminal reference
8 Civil action, administrative proceeding, and criminal reference
9 DK

40. Justification of Prosecutorial Status (6 MENTIONS)	1%

00 None
01 Referred to a self-regulatory agency
02 Referred to another government agency
03 Referred to another SEC division
04 No jurisdiction
05 Staleness, statute of limitations
06 Illegality insufficiently severe, magnitude limited, not enough victimization
07 Restitution made, rescission
08 Principal dead, defunct, inactive, terminated registration
09 Other proceedings, private actions, sanctions sufficient
10 Principals very cooperative
11 Other characteristics of principals, age, naivete
12 No self-benefit to principals
13 No evidence of fraud, not willful
14 Assumption of lack of interest by U.S. Attorney
15 No jury appeal
16 Victims very sophisticated
17 Technical legal questions, ambiguous issues, novel issues
18 Exhausted investigative procedures, lack of evidence, lack of good witnesses
19 More important cases pressing, workload
20 Special character of victims, insiders
21 Too difficult to prove fraud, intent
22 Cost of prosecution, investigation
23 Insufficient equity
24 Activity has ceased
25 Concern for deterrence, public values, impact
26 Settlement
27 Another jurisdiction is prosecuting, investigating
28 Some kind of assurances of corrective behavior
97 Commission refused proposed action
98 Other
99 DK

MISSING DATA

41. Other Non-SEC Proceedings Related to These Illegalities — 6%

0 None
1 Federal prosecutions
2 State civil
3 State criminal
4 Foreign (i.e. Canada)
5 NASD
6 Stock Exchange
7 Mixed
8 Other
9 DK

42. Private Civil Actions Related to These Illegalities — 9%

0 None
1 By victim(s)
2 In relation to bankruptcy
3 In relation to receivership
7 Mixed
8 Other
9 DK

43. Private Social Control (i.e. changes in management) Related to These Illegalities — 7%

0 None
1 Yes - probably not related to illegality
2 Yes - expulsion of principals, resignation, forced out
3 Yes - change of officers
4 Yes - receivership, liquidation
5 Yes - independent restitution
6 Controls
7 Mixed
8 Other
9 DK

MISSING DATA

43a. Unofficial SEC Remedies (4 MENTIONS) NA*

00 None
01 Withdraw registration
02 Cancel registration
03 Amend or correct prior filings
04 Supplemental reporting beyond that normally required
05 Freeze assets; freeze records
06 Appointment of special outside audit committee; peer review; limited receiver for disclosure purposes
07 Institution of internal corporate procedures; remedial education
08 Restrictions of business practices; limitation on SEC-related clients
09 Shift to a non-supervisory capacity
10 Reorganization of the management structure; change in the composition of the directors or executive committee
11 Appointment of receiver displacing incumbent management
12 Disgorgement; rescission, restitution; appoint receiver to allocate funds; requirement of party to divest self of interest in firm
13 Cannot be a broker, dealer, or principal without prior SEC approval; can't practice before Commission; assurances to stay out of securities business; other suspensions or bars
14 Resignations, firing of principals from firm
15 Dissolve firm
16 Statement admitting violations, to be used in any future disciplinary proceedings, will no further violate
17 Suspend trading
18 Canadian restricted list
19 Firm registers, files Reg A
98 Other
99 DK

*Only coded if information available.

CHARACTERISTICS OF PRINCIPALS

	MISSING DATA
44. Principal # _____	0%
45. Is Principal?	0%

1 Person
2 Corporate Officer or Director
3 Person Doing Business As, Sole Proprietorship
4 Corporation
5 Security
6 Partnership
9 DK

46. Type of Party (3 MENTIONS)	0%

01 Issuer
02 Promoter
03 Underwriter
04 Broker/Dealer
05 Investment Advisor
06 Investment Company (mutual fund)
07 Lawyer
08 Accountant
09 Public Relations
10 Corporate Insider
11 Securities Association
12 Securities Exchange
13 Specialist
14 Nominee
15 Bank
16 Government Body/Official
17 Member of Regulatory Agency
18 SEC member
19 Journalist
20 Stockholder
21 Insurance Company
22 Miscellaneous corporation
23 Miscellaneous private person
98 Other
99 DK

	MISSING DATA
47. Position in Firm (3 MENTIONS)	0%

0 Control person
1 President
2 Vice-President
3 Secretary/Treasurer
4 Other management
5 Salesman, registered representative
6 Entire firm, sole proprietor
7 Promoter
8 Other
9 DK
11 Lawyer, counsel
12 Other employee, consultant
14 General partner
15 Trustee
98 None

48. Director	8%

0 No
1 Yes
2 Chairman of the Board
9 DK

49. Beneficial Owner	10%

0 No
1 Yes
9 DK

50. Experience in Securities-Related Activity	19%

0 None
1 Experience in Issuer Field
2 Some Securities Experience
3 Considerable Securities Experience
8 Other
9 DK

51. Age	53%

1 Under 30
2 30-39
3 40-49
4 50-59
5 60-69
6 70+
7 Dead
9 DK

MISSING DATA

52. Region 6%

01	Alabama	34	Nevada
02	Alaska	35	New Hampshire
03	Arizona	36	New Jersey
04	Arkansas	37	New Mexico
05	California	38	New York
06	Los Angeles	39	New York City
07	San Francisco	40	North Carolina
08	Colorado	41	North Dakota
09	Connecticut	42	Ohio
10	Delaware	43	Oklahoma
11	D.C.	44	Oregon
12	Florida	45	Pennsylvania
13	Georgia	46	Philadelphia
14	Hawaii	47	Rhode Island
15	Idaho	48	South Carolina
16	Illinois	49	South Dakota
17	Chicago	50	Tennessee
18	Indiana	51	Texas
19	Iowa	52	Dallas, Ft. Worth
20	Kansas	53	Utah
21	Kentucky	54	Vermont
22	Louisiana	55	Virginia
23	Maine	56	Washington
24	Maryland	57	West Virginia
25	Massachusetts	58	Wisconsin
26	Boston	59	Wyoming
27	Michigan	60	Canada
28	Detroit	61	London
29	Minnesota	62	Glasgow
30	Mississippi	63	All over
31	Missouri	64	Other Foreign
32	Montana	65	Mexico
33	Nebraska	99	DK

53. Date First Registered with SEC 1%

000000	Never	777778	Formerly registered
------	Date	888888	Reg A, other exemption
999998	Yes, DK date	888889	Special (i.e. Stock Exchange)12g
999999	DK		

54. Listed on Stock Exchange 3%

0 No
1 Yes, currently
2 Yes, formerly
9 DK

	MISSING DATA
55. Member of NASD	4%

0 No
1 Yes, currently
2 Yes, formerly
9 DK

56. Best Guess on Age	10%

0 Doesn't exist
1 Less than 1 year
2 1 - 2 years
3 2 - 3 years
4 3 - 5 years
5 5 -10 years
6 10-20 years
7 20+ years
9 DK

57. Size/Wealth	11%

0 NA
1 Bankrupt/Insolvent, no assets
2 Small
3 Medium
4 Large
5 Extremely Large
9 DK

58. Region (Code offices, not state of incorporation)	1%

(Same code as #52)

59. Standard Industry Code	1%

Division A. Agriculture, forestry, and fishing
01 Agricultural production-crops
02 Agricultural production-livestock
05 General, combination
07 Agricultural services
08 Forestry
09 Fishing, hunting, and trapping
Division B. Mining
10 Metal mining
11 Anthracite mining
12 Bituminous coal and lignite mining
13 Oil and gas extraction
14 Mining and quarrying of nonmetallic minerals, except fuels

Division C. Construction
- 15 Building construction-general contractors and operative builders
- 16 Construction other than building construction-general contractors
- 17 Construction-special trade contractors
- 18 Development

Division D. Manufacturing
- 20 Food and kindred products
- 21 Tobacco manufacturers
- 22 Textile mill products
- 23 Apparel and other finished products made from fabrics and similar materials
- 24 Lumber and wood products, except furniture
- 25 Furniture and fixtures
- 26 Paper and allied products
- 27 Printing, publishing and allied industries
- 28 Chemicals and allied products
- 29 Petroleum refining and related industries
- 30 Rubber and miscellaneous plastic products
- 31 Leather and leather products
- 32 Stone, clay, glass, and concrete products
- 33 Primary metal industries
- 34 Fabricated metal products, except machinery and transportation equipment
- 35 Machinery, except electrical
- 36 Electrical and electronic machinery, equipment, and supplies
- 37 Transportation equipment
- 38 Measuring, analyzing, and controlling instruments; photo-, graphic, medical and optical goods; watches and clocks
- 39 Miscellaneous manufacturing industries

Division E. Transportation, communications, electric, gas, and sanitary services
- 40 Railroad transportation
- 41 Local and suburban transit and interurban highway passenger transportation
- 42 Motor freight transportation and warehousing
- 43 U.S. Postal Service
- 44 Water transportation
- 45 Transportation
- 46 Pipe lines, except natural gas
- 47 Transportation services
- 48 Communication
- 49 Electric, gas, and sanitary services

Division F. Wholesale trade
- 50 Wholesale trade-durable goods
- 51 Wholesale trade-nondurable goods

Division G. Retail trade
- 52 Building materials, hardware, garden supply and mobile home dealers
- 53 General merchandise stores
- 54 Food stores
- 55 Automotive dealers and gasoline service stations
- 56 Apparel and accessory stores
- 57 Furniture, home furnishings, and equipment stores
- 58 Eating and drinking places
- 59 Miscellaneous retail

Division H. Finance, insurance, and real estate
- 60 Banking
- 61 Credit agencies other than banks
- 62 Security and commodity brokers, dealers, exchanges, and services
- 63 Insurance
- 64 Insurance agents, brokers, and service
- 65 Real estate
- 66 Combinations of real estate, insurance loans, law offices
- 67 Holding and other investment offices
- 68 Finance, insurance, and real estate
- 69 Accountants

Division I. Services
- 70 Hotels, rooming houses, camps, and other lodging places
- 72 Personal services
- 73 Business services
- 75 Automotive repair, services, and garages
- 76 Miscellaneous repair services
- 78 Motion pictures
- 79 Amusement and recreation services, except motion pictures
- 80 Health services
- 81 Legal services
- 82 Educational services
- 83 Social services
- 84 Museums, art galleries, botanical and zoological gardens
- 86 Membership organizations
- 88 Private households
- 89 Miscellaneous services

Division J. Public administration
- 91 Executive, legislative, and general government, except finance
- 92 Justice, public order, and safety
- 93 Public finance, taxation, and monetary policy
- 94 Administration of human resources programs
- 95 Administration of environmental quality and housing programs
- 96 Administration of economic programs
- 97 National security and international affairs

Division K. Nonclassifiable establishments
- 90 Shell, dummy corporation
- 98 Nonclassifiable establishments
- 99 DK

	MISSING DATA
60. Recidivism	37%

0 None noted in file
1 Once
2 Twice
3 3 times
4 4 times
5 5+ times
6 DK - at least once
7 DK, but more than once
9 DK

61. Previous Substantive Violations, if recidivism known	7%

0 None
1 Basically same as in this case
2 Technical violations
3 Registration violations
4 Fraud
5 State - securities
6 Other white collar crime
7 Street crime
8 Mixture
9 DK

62. Previous Dispositions/Sanctions, if recidivism known	9%

0 None
1 Criminal
2 Civil
3 Administrative
4 Self-Regulatory
5 Mix
6 Warning Only
8 Other
9 DK

62A. Criminal Proceedings (CODE MOST SEVERE SANCTION)	2%

0 None mentioned
1 Acquittal
2 Conviction, no imprisonment, parole, probation
3 Conviction, fines only
4 Conviction, imprisonment once
5 Conviction, imprisonment more than once
8 Other
9 Criminal proceeding, DK outcome

MISSING DATA

62B. Civil Proceedings (CODE MOST SEVERE SANCTION) 0%

0 None mentioned
1 Injunction, dismissed
2 Federal injunction, once
3 Federal injunction, more than once
4 State proceedings
5 State and federal
8 Other
9 Civil proceeding, DK outcome

62C. Administrative Proceedings (CODE MOST SEVERE SANCTION) 0%

0 None mentioned.
1 Proceedings dismissed
2 Suspension or cause
3 Revocation or cause
4 Reg A, trading suspension
5 Bar from association
8 Other
9 Administrative proceeding, DK outcome

62D. Self-Regulatory Proceedings (CODE MOST SEVERE SANCTION) 0%

0 None mentioned
1 Proceedings dismissed
2 NASD
3 Stock exchange
4 Civil suit
8 Other
9 DK

63. Substantive Violations Alleged (20 MENTIONS) 0%

(USE ILLEGALITY CODE - #20)

VICTIMIZATION

	MISSING DATA
64. Approximate Number of Victims	1%

0 Less than 5
1 5 - 10
2 11 - 25
3 26 - 50
4 51 -100
5 101-200
6 201-500
7 501-1000
8 1000+
9 DK

Were Victims Predominantly?

65.	0%

1 Individuals
2 Organizations (investing)
3 Organizations (service - banks, B/D)
4 Both
9 DK

66.	0%

1 Purchasers
2 Sellers
3 Stockholders throughout
4 Mixed
5 Investors/clients
8 Other
9 DK

67.	21%

1 Novices
2 Casual investors
3 Seasoned investors
4 Mixed
9 DK

68.	25%

1 Very wealthy
2 More middle class
3 Mixed
9 DK

	MISSING DATA
69. Relationship of Victims to Principal	4%

0 Mixed
1 "Boiler Room" type relationship
2 Strangers
3 Casual relationship
4 Relationship - employee, etc.
5 Long time client
6 Friends, family
7 Special recruitment program (i.e. gospel meetings)
8 Other
9 DK

70. Relationship to Other Victims	11%

0 NA
1 All strangers
2 Groups of associates
3 All associates
4 Truly mixed
9 DK

71. Geographic Dispersion	2%

1 Same city
2 Same state
3 Same region
4 National
5 International
9 DK

ADMINISTRATIVE PROCEEDING

	MISSING DATA
72. Principal #s Applicable to	
0 All	
# Otherwise	
73. Type Proceeding	0%
1 B/D revocation/cause	
2 B/D denial/cause	
3 B/D withdrawal/cause	
4 B/D cancellation/cause	
5 Suspend/withdraw stock exchange registration	
6 Reg A suspension	
7 8(e) - registration statement; 8(d) stop order	
8 Other	
9 DK	
74. Public/Private Proceeding?	2%
0 NA	
1 Public	
2 Private	
8 Other	
9 DK	
75. Date of Order Initiating Proceedings	0%
000000 None, NA	
------ Date	
999999 DK	
76. Date of Hearing	0%
000000 None, NA	
------ Date	
999999 DK	
77. Date of Oral Argument	0%
000000 None, NA	
------ Date	
999999 DK	
78. Date of Opinion, Findings	0%
000000 None, NA	
------ Date	
999999 DK	

MISSING DATA

79. Location of Hearing — 0%

00	None	11	Cleveland
01	New York	12	Los Angeles
02	Boston	13	Detroit
03	Atlanta	14	Minneapolis
04	Chicago	15	St. Louis
05	Ft. Worth	16	Tulsa
06	Denver	17	St. Lake City
07	San Francisco	18	Houston
08	Seattle	19	Miami
09	Washington Regional	20	Philadelphia
10	Home Office	21	Other
		99	DK

80. Disposition By: — 0%

0 NA
1 Consent/Settlement
2 Litigation/Hearing
3 Default
8 Other
9 DK

81. Disposition — 0%

0 NA
1 No violation
2 Violation
7 Dismissed, Discontinue Proceeding
8 Other
9 DK

82. Sanction (3 MENTIONS) — 0%

00 None
01 Censure
02 Suspension/cause
03 Bar from association
04 Revoke Registration/cause
05 Deny Registration/cause
06 Suspend from NASD
07 Suspend from Security Exchange
08 Expell from NASD
09 Expell from Security Exchange
10 Denial of privilege to appear or practice before Commission
11 Stop order
12 Suspend Reg A
13 Suspend from Association
98 Other
99 DK

MISSING DATA

83. Length of Suspension or Bar — 0%

0 None, NA, permanent
1 10 days or less
2 11 - 20 days
3 21 - 30 days
4 1 - 3 months
5 3 - 6 months
6 6 - 9 months
7 9 -12 months
8 1 year
9 DK

84. Ancillary Remedies (3 MENTIONS) — 0%

00 None
01 Withdraw registration
02 Cancel registration
03 Amend or correct prior filings
04 Supplemental reporting beyond that normally required
05 Freeze assets; freeze records
06 Appointment of special outside audit committee; peer review; limited receiver for disclosure purposes
07 Institution of internal corporate procedures; remedial education
08 Restrictions of business practices; limitations on SEC-related clients
09 Shift to a non-supervisory capacity
10 Reorganization of the management structure; change in the composition of the directors or executive committee
11 Appointment of receiver displacing incumbent management
12 Disgorgement; rescission, restitution; appoint receiver to allocate funds; requirement of party to divest self of interest in firm
13 Cannot be a broker, dealer, or principal without prior SEC approval
14 Stay out of securities business
98 Other
99 DK

85. Appeals and Disposition — 0%

0 No
1 Yes - affirm
2 Yes - reverse
3 Yes - change sanction
4 Yes - change ancillary relief
8 Other
9 DK

CIVIL ACTION

MISSING DATA

86. Principals #s Applicable to

0 All
Otherwise

87. Date Complaint Filed — 0%

000000 None
------ Date
999999 DK

88. Date of Temporary Restraining Order — 0%

000000 None
------ Date
999999 DK

89. Date of Preliminary Injunction — 0%

000000 None
------ Date
999999 DK

90. Date of Permanent Injunction — 0%

000000 None
------ Date
999999 DK

91. Jurisdiction of Court — 0%

Alabama
1 Northern district --- Birmingham
2 Middle district ----- Montgomery
3 Southern district --- Mobile
4 Alaska ---------- Anchorage
5 Arizona ---------- Phoenix
Arkansas
6 Eastern district --- Little Rock
7 Western district --- Fort Smith
California
8 Northern district -- San Francisco
9 Eastern district --- Sacramento
10 Central district --- Los Angeles
11 Southern district -- San Diego
12 Canal Zone ---------- Ancon
13 Colorado ---------- Denver
14 Connecticut ---------- New Haven

15 Delaware ---------- Wilmington
16 District of Columbia --- Washington
Florida
17 Northern district -- Tallahassee
18 Middle district ---- Jacksonville
19 Southern district -- Miami
Georgia
20 Northern district -- Atlanta
21 Middle district ---- Macon
22 Southern district -- Savannah
23 Guam ---------- Agana
24 Hawaii ---------- Honolulu
25 Idaho ---------- Boise
Illinois
26 Northern district -- Chicago
27 Eastern district -- East St. Louis
28 Southern district -- Springfield
Indiana
29 Northern district -- Hammond
30 Southern district -- Indianapolis
Iowa
31 Northern district -- Cedar Rapids
32 Southern district -- Des Moines
33 Kansas ---------- Wichita
Kentucky
34 Eastern district --- Lexington
35 Western district --- Louisville
Louisiana
36 Eastern district --- New Orleans
37 Middle district ---- Baton Rouge
38 Western district --- Shreveport
39 Maine ---------- Portland
40 Maryland ---------- Baltimore
41 Massachusetts ---------- Boston
Michigan
42 Eastern district --- Detroit
43 Western district --- Grand Rapids
44 Minnesota ---------- St. Paul
Mississippi
45 Northern district -- Oxford
46 Southern district -- Jackson
Missouri
47 Eastern district --- St. Louis
48 Western district --- Kansas
49 Montana ---------- Butte
50 Nebraska ---------- Omaha
51 Nevada ---------- Reno
52 New Hampshire ---------- Concord
53 New Jersey ---------- Trenton
54 New Mexico ---------- Albuquerque

New York
55 Northern district — Utica
56 Eastern district — Brooklyn
57 Southern district — New York
58 Western district — Buffalo
North Carolina
59 Eastern district — Raleigh
60 Middle district — Greensboro
61 Western district — Asheville
62 North Dakota — Fargo
Ohio
62 Northern district — Cleveland
64 Southern district — Columbus
Oklahoma
65 Northern district — Tulsa
66 Eastern district — Muskegee
67 Western district — Oklahoma City
68 Oregon — Portland
Pennsylvania
69 Eastern district — Philadelphia
70 Middle district — Scranton
71 Western district — Pittsburgh
72 Puerto Rico — San Juan
73 Rhode Island — Providence
74 South Carolina — Columbia
75 South Dakota — Sioux Falls
Tennessee
76 Eastern district — Knoxville
77 Middle district — Nashville
78 Western district — Memphis
Texas
79 Northern district — Dallas
80 Eastern district — Beaumont
81 Southern district — Houston
82 Western district — San Antonio
83 Utah — Salt Lake City
84 Vermont — Burlington
Virginia
85 Eastern district — Norfolk
86 Western district — Roanoke
87 Virgin Islands — St. Thomas
Washington
88 Eastern district — Spokane
89 Western district — Seattle
West Virginia
90 Northern district — Elkins
91 Southern district — Charleston
Wisconsin
92 Eastern district — Milwaukee
93 Western district — Madison
94 Wyoming — Cheyenne
99 DK

MISSING DATA

92. Action (NOTE "HIGHEST") 0%

0 None
1 Temporary Restraining Order
2 Temporary Injunction
3 Permanent Injunction
4 Only Ancillary remedy
8 Other
9 DK

93. Disposition 0%

1 Enjoined
2 Not enjoined
3 Dismissed
4 Withdrawn
5 Not enjoined, but "guilty"
8 Other
9 DK

94. Disposition By: 0%

1 Consent
2 Litigation
3 Default
9 DK

95. Ancillary Remedies (3 MENTIONS) 0%

00 None
01 Amend or correct prior filings, or simply file
02 Supplemental reporting beyond that normally required
03 Freeze assets; freeze records
04 Appointment of special outside audit committees; peer review; limited receiver for disclosure purposes
05 Institution of internal corporate procedures; remedial education
06 Restrictions on business practices; limitation on SEC-related clients
07 Orders pertaining to proxy solicitations or the voting of shares
08 Reorganization of the management structure; change in the composition of the directors of executive committee
09 Other suspensions or bars
10 Appointment of receiver displacing incumbent management
11 Disgorgement; rescission; restitution; appoint receiver to allocate funds; requirement of party to divest self of interest in firm
12 Liquidate firm
98 Other
99 DK

	MISSING DATA
96. Appeals and Disposition	0%

0 No
1 Yes - affirm
2 Yes - reverse
3 Yes - change ancillary relief
8 Yes - other, too many appeals to sort out
9 DK

CRIMINAL REFERENCE TO JUSTICE DEPARTMENT

	MISSING DATA
97. Principal #s Applicable to	
0 All # Otherwise	
98. Date of Reference	0%
000000 None ------ Date 999999 DK	
99. Were Files?	6%
0 NA 1 Requested 2 Referred 3 Some combination 9 DK	
100. Was Referral Declined?	0%
0 No 1 Yes (elaborate) 7 NA 8 Special 9 DK	
101. Jurisdiction of Referral (SEE CODE #91)	0%
00 NA 01-94 Federal District Code 95 Only Justice Department 96 County DA 99 DK	
102. Date of Indictment	0%
000000 None ------ Date 999999 DK 888888 Unindicted co-conspirator	

MISSING DATA

103. Charge (NOTE COUNTS) 0%

01 '33 - 5's
02 '33 - 17
03 '34 - 10(b) 10b-5
04 '34 - 15(c) 15(c)(1) 15cl-2
11 5 & 17
12 5 & 10
13 5 & 15
14 17 & 10
15 17 & 15
16 10 & 15
21 5 & 17 & 10
22 5 & 17 & 15
23 5 & 10 & 15
24 17 & 10 & 15
31 5 & 17 & 10 & 15
41 5 & contempt
96 Parole violation
97 Contempt
98 Other
99 DK

104. Additional Charges (NOTE COUNTS) 0%

0 No more
1 Mail fraud
2 Conspiracy
3 Perjury, false statements
4 Mail fraud and conspiracy
5 Mail fraud and perjury
6 Conspiracy and perjury
7 Mail fraud, conspiracy, and perjury
8 Other
9 DK

105. Plea (NOTE CHARGES) 0%

0 NA
1 Innocent - convicted
2 Innocent - not convicted
3 Guilty
4 Nolo contendere
8 Other
9 DK

MISSING DATA

106. Sentence (TWO MENTIONS) 0%

0 Not guilty
1 Probation - actual
2 Probation - suspended
3 Imprisonment - actual
4 Imprisonment - suspended
5 Fine
6 Restitution
7 Nol Prossed, dismiss indictment
8 Other
9 DK

107. Length Sentence, Probation (TWO MENTIONS) 0%

0 None
1 One month or less
2 1+ - 3 months
3 3+ - 6 months
4 6+ - 9 months
5 9+ -12 months
6 1+ - 2 years
7 2+ - 3 years
8 More than 3 years
9 DK

108. Appeals and Disposition 0%

0 No
1 Yes - affirm
2 Yes - reverse
3 Yes - change sentence
8 Yes - other
9 DK

APPENDIX B: CODING FORMS

MAIN CODE SHEET

1. Docket #
2. Location
3. Opened
4. Closed
5. Initiated
6. Completed
7. Formal Order
8. Coded
9. Time
10. Magnitude

11. Source
    (date)
12. # Complainants
13. Region Complainant
14. Allegation
15. Statute
16. Delinquent
17. Other
18. Type Case
19. Period
20. Illegality
21. Magnitude
22. Media
23. Victimization

Docket # _____

PRINCIPALS

45. Principal # _____

46. Principal _____

47. Type _____

48. Position _____ _____ _____

49. Director _____

50. Beneficial _____

51. Experience _____

52. Age _____

53. Region _____

54. SEC _____

55. Stock Exchange _____

56. NASD _____

57. Age _____

58. Size _____

59. Region _____

60. SIC _____

61. Recidivism _____

62. Violations _____

63. Dispositions _____

_____

_____

64. Violations _____ _____ _____ _____ _____ _____

Docket # _____

VICTIMIZATION

65. Number _____

66. Indiv/Organiz _____

67. Purchasers _____

68. Novices _____

69. Wealth _____

70. Rel. to Principals _____

71. Rel. to Victims _____

72. Geographic _____

Docket # _____

ADMINISTRATIVE PROCEEDING

73. Principals _____ _____ _____ _____ _____

74. Type _____

75. Public/Private _____

76. Order _____

77. Hearing _____

78. Oral Argument _____

79. Opinion _____

80. Location _____

81. Disposition By _____

82. Disposition _____

83. Sanction _____ _____

84. Length _____

85. Ancillary _____ _____

86. Appeals _____

Docket # _____

CIVIL ACTION

87. Principals _____ _____ _____ _____ _____

88. Filed _____

89. TRO _____

90. Temp. Injunction _____

91. Perm. Injunction _____

92. Jurisdiction _____

93. Action _____

94. Disposition _____

95. Disposition By _____

96. Ancillary _____ _____

97. Appeals _____

Docket # _____

CRIMINAL REFERENCE

98. Principals _____ _____ _____ _____ _____

99. Date Reference _____

100. Requested _____

101. Declined _____

102. Jurisdiction _____

103. Date Indictment _____

104. Charge _____

105. Addl. Charge _____

106. Plea _____

107. Sentence _____

108. Length _____

109. Appeals _____

APPENDIX C: TYPES OF PROCEEDINGS*

ADMINISTRATIVE PROCEEDINGS

Persons Subject to, Acts Constituting, and Basis for, Enforcement Action	Sanction
Broker-dealer, municipal securities dealer, investment advisor or associated person	
Willful violation of securities acts provision or rule; aiding or abetting such violation; failure reasonably to supervise others; willful misstatement or omission in filing with the Commission; conviction of or injunction against certain crimes or conduct.	Censure or limitation on activites; revocation, suspension or denial of registration; bar or suspension from association (1934 Act, 15B(c) (2)-(4), (15(b) (4)-(6); Advisors Act, 203(e)-(f)).**
Registered securities association	
Organization or rules not conforming to statutory requirements.	Suspension of registration or limitation of activities, functions, or operations (1934 Act, 19(h) (1)).
Violation of or inability to comply with the 1934 Act, rules thereunder, or its own rules; unjustified failure to enforce compliance with the foregoing or with rules of the Municipal Securities Rulemaking Board by a member or person associated with a member.	Suspension or revocation of registration; censure or limitation of activities, functions, or operations (1934 Act, 19(h) (1)).

*Taken from SEC ANNUAL REPORT 1977, pp. 322-4.

**Statutory references are as follows: "1933 Act", the Securities Act of 1933; "1934 Act", the Securities Exchange Act of 1934; "Investment Company Act", the Investment Company Act of 1940; "Advisers Act", the Investment Advisers Act of 1940; "Holding Company Act", the Public Utility Holding Company Act of 1935; "Trust Indenture Act", the Trust Indenture Act of 1939; and "SIPA", the Securities Investor Protection Act of 1970.

ADMINISTRATIVE PROCEEDINGS, continued

Persons Subject to, Acts Constituting, and Basis for, Enforcement Action	Sanction
Member of registered securities association, or associated person	
Being subject to Commission order pursuant to 1934 Act, 15(b); willful violation of or effecting transaction for other person with reason to believe that person was violating securities acts provisions, rules thereunder, or rules of Municipal Securities Rulemaking Board.	Suspension or expulsion from the association; bar or suspension from association with member of association (1934 Act, 19(h) (2)-(3)).
National securities exchange	
Organization or rules not conforming to statutory requirements.	Suspension of registration or limitation of activities, functions, or operations (1934 Act, 19 (h) (1)).
Violation of or inability to comply with 1934 Act, rules thereunder or its own rules; unjustified failure to enforce compliance with the foregoing by a member or person associated with a member.	Suspension or revocation of registration censure or limitation of activities, functions, or operations (1934 Act, 19(h) (1)).
Member of national securities exchange, or associated persons	
Being subject to Commission order pursuant to 1934 Act, 15(b); willful violation of or effecting transaction for other person with reason to believe that person was violating securities acts provisions or rules thereunder.	Suspension or expulsion from exchange; bar or suspension from association with member (1934 Act, 19(h) (2)-(3)).
Registered clearing agency	
Violation of or inability to comply with 1934 Act, rules thereunder, or its own rules; failure to enforce compliance with its own rules by participants.	Suspension or revocation of registration censure or limitation of activities, functions, or operations (1934 Act, 19(h) (1)).

ADMINISTRATIVE PROCEEDINGS, continued

Persons Subject to, Acts Constituting, and Basis for, Enforcement Action	Sanction
Participant in registered clearing agency	
Being subject to Commission order pursuant to 1934 Act, 15(b) (4); willful violation of or effecting transaction for other person with reason to believe that person was violating provisions of clearing agency rules.	Suspension or expulsion from clearing agency (1934 Act, 19(h) (2)).
Securities information processor	
Violation of or inability to comply with provisions of 1934 Act or rules thereunder.	Censure or operational limitations; suspension or revocation of registration (1934 Act, 11A(b) (6)).
Transfer agent	
Willful violation of or inability to comply with 1934 Act, 17 or 17A, or regulations thereunder.	Censure or limitation of activities; denial, suspension, or revocation of registration (1934 Act, 17A(c) (3)).
Any person	
Willful violation of securities act provision or rule; aiding or abetting such violation; willful misstatement in filing with Commission.	Temporary or permanent prohibition from serving in certain capacities for registered investment company (Investment Company Act, 9(b)).
Officer or director of self-regulatory organization.	
Willful violation of 1934 Act, rules thereunder, or the organization's own rules; willful abuse of authority or unjustified failure to enforce compliance.	Removal from office or censure (1934 Act, 19(h) (4)).
Principal of broker-dealer	
Engaging in business as a broker-dealer after appointment of SIPC trustee.	Bar or suspension from being or being associated with a broker-dealer (SIPC, 10(b)).

ADMINISTRATIVE PROCEEDINGS, continued

Persons Subject to, Acts Constituting, and Basis for, Enforcement Action	Sanction
1933 Act registration statement	
Statement materially inaccurate or incomplete.	Stop order suspending effectiveness (1933 Act, 8(d)).
Investment company has not attained $100,000 net worth 90 days after statement became effective.	Stop order (Investment Company Act, 14(a)).
Persons subject to Sections 12, 13 of 15(d) of the 1934 Act.	
Material noncompliance with such provisions.	Order directing compliance (1934 Act, 15(c) (4)).
Securities issue	
Noncompliance by issuer with 1934 Act or rules thereunder.	Denial, suspension of effective date, suspension or revocation of registration on national securities exchange (1934 Act, 12(j)).
Public interest requires trading suspension.	Summary suspension of over-the-counter or exchange trading (1934 Act, 12(k)).
Registered investment company	
Failure to file Investment Company Act registration statement or required report, filing materially incomplete or misleading statement of report.	Revocation of registration (Investment Company Act, 8(e)).
Company has not attained $100,000 net worth 90 days after 1933 Act registration statement became effective.	Revocation or suspension of registration (Investment Company Act, 14(a)).

ADMINISTRATIVE PROCEEDINGS, continued

Persons Subject to, Acts Constituting, and Basis for, Enforcement Action	Sanction
Attorney, accountant, or other professional or expert	
Lack of requisite qualifications to represent others; lacking in character or integrity; unethical or improper professional conduct; willful violation of securities laws or rules; or aiding and abetting such violation.	Permanent or temporary denial of privilege to appear or practice before the Commission (17 C.F.R. 201.2(e) (1)).
Attorney suspended or disbarred by court, expert's license revoked or suspended; conviction of a felony or misdemeanor involving moral turpitude.	Automatic suspension from appearance or practice before the Commission (17 C.F.R. 201.2(e) (2)).
Permanent injunction against or finding of securities violation in Commission-instituted action; finding of securities violation by Commission in administrative proceeding.	Temporary suspension from appearance or practice before Commission (17 C.F.R. 201.2(e) (3)).
Member of Municipal Securities Rulemaking Board	
Willful violation of securities laws, rules thereunder, or rules of the Board.	Censure or removal from office 1934 Act, 15b(c) (8)).

CIVIL PROCEEDINGS IN FEDERAL DISTRICT COURTS

Persons Subject to, Acts Constituting, and Basis for, Enforcement Action	Sanction
Any person	
Engaging in or about to engage in acts or practices violating securities acts, rules or orders thereunder (including rules of a registered self-regulatory organization)	Injunction against acts or practices which constitute or would constitute violations (plus other equitable relief under court's general equity powers) (1933 Act, Sec. 20(b); 1934 Act, Sec. 21(d); 1935 Act, Sec. 18(f); Investment Company Act. 42(e); Advisers Act, 209(e); Trust Indenture Act, 321).
Noncompliance with provisions of law, rule, or regulation under 1933, 1934, or Holding Company Acts, order issued by Commission rules of a registered self-regulatory organization, or undertaking in a registration statement.	Writ of mandamus, injunction, or order directing compliance (1933 Act, 20(c); 1934 Act, 21(e); Holding Company Act, 18(g)).
Securities Investor Protection Corporation	
Refusal to commit funds or act for the protection of customers.	Order directing discharge of obligations or other appropriate relief (SIPA, 7(b)).
National securities exchange or registered securities association	
Noncompliance by its members and persons associated with its members with the 1934 Act, rules and orders thereunder, or rules of the exchange or association.	Writ of mandamus, injunction, or order directing such exchange or association to enforce compliance (1934 Act, 21(e)).
Registered clearing agency	
Noncompliance by its participants with its own rules.	Writ of mandamus, injunction, or order directing clearing agency to enforce compliance (1934 Act, 21(e)).

CIVIL PROCEEDINGS IN FEDERAL DISTRICT COURTS, continued

Persons Subject to, Acts Constituting, and Basis for, Enforcement Action	Sanction
Issuer subject to reporting requirements	
Failure to file reports required under 15(d) of 1934 Act.	Forfeiture of $100 per day (1934 Act, 32(b)).
Registered investment company or affiliate	
Name of company or of security issued by it deceptive or misleading.	Injunction against use of name (Investment Company Act, 35(d)).
Officer, director, member of advisory board, adviser, depositor, or underwriter of investment company	
Engage in act or practice constituting breach of fiduciary duty involving personal misconduct.	Injunction against acting in certain capacities for investment company, and other appropriate relief Investment Company Act, 36(a)).
Any person having fudiciary duty respecting receipt of compensation from investment company	
Breach of fiduciary duty.	Injunction (Investment Company Act, 36(a)).

REFERRAL TO ATTORNEY GENERAL FOR CRIMINAL PROSECUTION

Persons Subject to, Acts Constituting, and Basis for, Enforcement Action	Sanction
Any person	
Willful violation of Securities acts or rules thereunder or willful misstatement in any document required to be filed by securities laws and rules or by self-regulatory organization in connection with an application for membership, participation or to become associated with a member thereof.	Maximum penalties: $10,000 fine and 5 years imprisonment; an exchange may be fined up to $500,000, a public-utility holding company up to $200,000 (1933 Act, Secs. 20(b), 24; 1934 Act, Secs. 21(d), 32(a); Holding Company Act, Sec. 18(f), 29; 1939 Act, Sec. 325; Investment Company Act, Secs. 42(e), 49; Advisers Act, Secs. 209(e), 217).

APPENDIX D: ALLEGED STATUTORY VIOLATION UNDER INVESTIGATION

	(N)	%
SECURITIES ACT OF 1933		
5	(297)	56%
17	(338)	64%
24	(4)	1%
19A	(2)	*
SECURITIES EXCHANGE ACT OF 1934		
7C-REG T	(14)	3%
8C	(2)	*
9	(8)	2%
10B,10B-5	(211)	40%
10B-6	(18)	3%
X-12B	(1)	*
13A	(4)	1%
13B	(1)	*
14A	(3)	1%
14A-3	(1)	*
14A-9	(1)	*
15	(12)	2%
15A	(12)	2%
15B	(19)	4%
15B-1	(2)	*
15B-2	(13)	2%
15B1	(3)	1%
15B1-1	(2)	*
15B3-1	(5)	1%
15B8	(2)	*
15C1	(1)	*
15C1-2	(86)	16%
15C1-4	(12)	2%
15C1-5	(3)	1%
15C1-6	(3)	1%
15C1-8	(1)	*
15C2-1	(9)	2%
15C2-4	(5)	1%
15C3	(1)	*
15C3-1	(53)	10%
15C3-2	(1)	*
15C5	(3)	1%
15D	(2)	*
16	(2)	*
17	(10)	2%
17A-3	(55)	10%
17A-4	(19)	4%
17A-5	(42)	8%
17A-11	(4)	1%
20	(2)	*
32A	(6)	1%

	(N)	%
INVESTMENT COMPANY ACT OF 1940		
3	(1)	*
7	(6)	1%
7A	(1)	*
13A2	(1)	*
15A1	(1)	*
17	(1)	*
17A3	(3)	1%
17E1	(3)	1%
20A	(2)	*
21A	(1)	*
22D	(1)	*
22E	(1)	*
30	(1)	*
34B	(1)	*
36	(4)	1%
37	(3)	1%
48A	(1)	*
INVESTMENT ADVISORS ACT OF 1940		
203	(5)	1%
204	(4)	1%
205	(1)	*
206	(12)	2%
207	(3)	1%
208	(1)	*
SEC RULES OF PRACTICE		
2E	(1)	*
DON'T KNOW	(3)	1%
TOTAL CASES	(526)	

APPENDIX E: GENERAL CATAGORIES OF ILLEGALITY

REGISTRATION VIOLATIONS - SECURITY
- Of a security - general
- Of a security - interstate
- Of a security - public/private
- Of a security - secondary distribution by insiders, promotional
- Of a security - inadvertent, novel issue
- Of a security - creating false impression it's exempt
- Premature solicitation, gun jumping

REGISTRATION VIOLATIONS - PROFESSIONAL
- Of a professional - general
- Of a professional - inadvertent
- Of a professional - intentional

TECHNICAL VIOLATIONS - ISSUERS
- Exceed Reg A Limit
- Other Filing Problems
- Filing proxy materials

TECHNICAL VIOLATIONS - BROKER-DEALERS
- Delinquent Filings (reporting violations)
- Bookkeeping Rules (record keeping)
- Net Capital Violations
- Improper Extension of Credit
- Failure to Deliver Security (non-fraud)
- Hypothecation Rules (non-fraud)
- Reg T Problems - use of securities as collateral for loans
- Escrow account for Underwriter
- Confirmation Rules
- Other

BROKER-DEALER SALES TECHNIQUES
- Malpractice/Improper Sales Techniques
  - Failure to consider suitability of stock for client
  - Inappropriate advice
  - Failure to obtain the best price
  - Failure to confirm
  - Selling without an offering circular, failure to deliver prospectus
  - Employing known violators
  - Improper supervision
  - Failure to investigate stock
  - Failure to supervise, scrutinize, direct -- by director
  - Interpositioning
  - Parking
  - Other

BOILER ROOMS
- Boiler room tactics
- High pressure sales

PREVIOUS SOCIAL CONTROL
- Violations Related to Previous Social Control
  - Working while suspended
  - Violation of injunction, parole, suspension
  - Disclosure of previous social control
  - Previously working for firm subject to social control
  - Creation of organization to bypass social control, front

GENERAL MISREPRESENTATIONS
- General Misrepresentations and Omissions
  - General Puffing
  - Touting, undisclosed compensation
- Other

MISREPRESENTATIONS ABOUT THE STATUS OF THE CORPORATION
- About Corporate Entity (Issuer, B/D, IC, IA)
  - Financial condition, earnings, etc.
  - Important Developments (i.e. lawsuits)
  - Corporate structure - affiliates
  - Source of corporate assets
  - Actual resources, production capability
  - Business operations (issuer)
  - Brokerage related business operations, financial condition

MISREPRESENTATIONS ABOUT THE FUTURE OF THE CORPORATION
- Risks, soundness
- General prospects, pending corporate actions, contracts, sales
- Prospects pertaining to corporate organization - mergers, acquisitions

MISREPRESENTATIONS ABOUT CORPORATE INSIDERS
- Previous employment, principals, officers, directors, background, experience
- Questionable business operations, slush funds, bribes payoffs, commissions, illegal campaign contributions
- Remuneration of corporate officers
- Beneficial interests, security holdings of insiders
- Other management issues
- Self-dealing by insiders
- Interests of insiders in corporate transactions

MISREPRESENTATIONS ABOUT CORPORATE OVERSIGHT
- That it is registered with SEC, needs to be, or is exempt
- That it is listed on a stock exchange, or will be
- That corporation is supervised by some regulatory agency

MISREPRESENTATIONS ABOUT THE STOCK OFFERING
- About Stock, Its Distribution, Its Market
  - Stock ownership, source of stock
  - Selling non-existant securities
  - Selling more securities than stated capitalization, than can be supplied
  - Kind of stock - i.e. unissued capital stock when it was privately owned
  - Other quality of stock - i.e. classes
  - Use of stock sale proceeds
  - Price - current (market value)
  - Information about present distribution, underwriting plan
  - Information about number of shares offered, number outstanding
  - Not a bona fide public offering
  - About forthcoming stock issuance
  - About market for stock
  - Reason for wanting shares
  - Identity of purchasers, investors
  - Other
  - About stock redemption, repurchase
  - Unexplained price rise, etc.

MISREPRESENTATIONS ABOUT THE BROKER-DEALER'S ROLE IN THE OFFERING
- About one's role in distribution - agent, principal, undisclosed underwriter
- About one's role in transaction - broker, dealer, etc.
- Trading while engaged in distribution (10b-6)
- Profits and compensation to brokers and underwriters

MISREPRESENTATIONS ABOUT RETURN ON INVESTMENT
- About repayment of bonds, loan
- About dividends, return on investment
- Price - future; that it would rise; good for a quick profit

MISREPRESENTATIONS ABOUT INVESTMENT ADVICE
- About Form of Investment Advice
  - Source of information (i.e. inside information, tipping)
  - Other

INVESTMENT SCHEMES
- Ponzi schemes
- Shell corporations, spin-offs
- Advanced fee swindle, front money
- Other

STOCK MANIPULATION
- Manipulation
- Manipulation - wash sales
- Manipulation - matched orders
- Manipulation - painting the tape
- Manipulation - putting bids in sheets to create facade of trading

CLEAR-CUT MISAPPROPRIATIONS
- Embezzlement
  - Misappropriation of funds
  - Use of stock proceeds for personal living
  - Conversion of customer stock and proceeds of sale, bucket shops

LESSER MISAPPROPRIATIONS
- Use of stock proceeds for plush offices, etc.
- Transfer of personal indebtedness to corporation
- Didn't hold customer's securities in safekeeping
- Use of customer's stock as personal collateral
- Failure to deliver securities (fraud)
- Hypothecation (fraud)
- Sending confirmations to persons who hadn't ordered, false confirmations
- Abuse of discretionary accounts
- Churning - for commissions
- Other churning
- Cross-trading
- Inappropriate, excessive, multiple commissions
- Charging excessive prices, markups
- Failure to pay for securities
- Loading and reloading
- Won't honor repurchase or reexchange agreement
- Pledging worthless stock as collateral
- Other

SELF-DEALING
- Self Dealing
  - Conflicts of interest
  - Insider trading, tipping (self-dealing)
  - Kickbacks, commissions, bribery
  - Scalping - touting a stock to take advantage of market
  - Abuse of fiduciary duty
  - Other

APPENDIX F: THE OFFENSE SIGNIFICANCE SCALE

The offense significance scale is based on the aggregation of information concerning the type of illegality, the duration of illegality, the number of offenders, victimization, and the economic magnitude of the offense. The last two components of the index are weighted more heavily than the first three. Each case is assigned a value on each component of the significance index, which are then summed. The criteria and weights associated with each component value is presented below.

TYPE OF ILLEGALITY

0 Technical Violation Only
1 Registration Violation Only
2 Misrepresentation Only
3 Misappropriation Only, Misappropriation and Nonregistration Only
Misappropriation and Misrepresentation Only
4 Nonregistration and Misrepresentation Only
5 Misappropriation, Nonregistration, and Misrepresentation Only
6 Any Offense with Elements of Stock Manipulation or Self Dealing

DURATION OF ILLEGALITY

0 Don't know, Less than 4 Months
1 4 - 9 Months
2 9 -15 Months
3 15 Months - 2 Years
4 2 Years - 4 Years
5 More Than 4 Years

NUMBER OF OFFENDERS

0 One
1 Two
2 Three - Five
3 Six - Ten
4 Eleven - Fifteen
5 More Than Fifteen

VICTIMIZATION

0	No Victims
2	Don't Know
3	Less Than 10
4	11 - 25
5	26 - 50
6	51 - 100
7	101 - 200
8	201 - 500
9	501 - 1,000
10	1,000 +

ECONOMIC MAGNITUDE OF OFFENSE

0	None
1	Don't Know
2	$100 - $1,000
3	$1,001 - $5,000
4	$5,001 - $10,000
5	$10,001 - $25,000
6	$25,001 - $100,000
7	$100,001 - $500,000
8	$500,001 - $1,000,000
9	$1,000,001 - $2,500,000
10	$2,500,001 +

The significance scale, a sum of each of these values, can range from 0 to 36. Actual Values ranged from 0 to 33, with a median of 13.6, a mean of 13.5, and a standard deviation of 7.6.

For purpose of crosstabular analysis, this scale was recoded into 5 more or less equal categories as follows:

SIGNIFICANCE VALUE	N	%
0 - 5	105	20%
6 - 11	102	19%
12 - 15	98	19%
16 - 20	114	22%
21 - 36	107	20%

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