

TESTIMONY OF PETER C. HARVEY
New Jersey Attorney General

“The Role of State Securities Regulators in Protecting Investors”

Committee on Banking, Housing and Urban Affairs
United States Senate

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Chairman Shelby, Ranking Member Sarbanes and Members of the Committee. I am

Peter Harvey, Attorney General for the State of New Jersey. Thank you for inviting me to testify today on the issue of state regulation and enforcement of securities laws.

The states play a critical role in regulating securities. By highlighting what we are doing in New Jersey, I hope to illustrate clearly why the states are a crucial component of investor protection in this nation. I want to acknowledge and thank Senator Jon Corzine, who was a wise and experienced leader in the investment industry and now devotes his wisdom and leadership in service of the nation and New Jersey. I want to thank him particularly for being a strong advocate for investor education and protection.

A. State Regulatory Oversight

The securities markets have attracted investors large and small. Many middle-class Americans seek to build their assets for their children's college education and retirement by investing in stocks and bonds. These days, most of the money is not in banks. It's invested in securities, predominantly through pension plans, private retirement plans (401K, Keough, IRA) and major mutual funds, but also through private broker-dealers. Thirty years ago, only a small fraction of U.S. citizens ventured into the securities markets. Now, we have nearly 100 million investors. That's a lot of people and a lot of money.

Unfortunately, there are plenty of modern-day Willie Suttons – armed with a sales pitch instead of a gun – who know where the money is and have learned that many investors are easy

marks for a scam. Those investors are spread over 50 states – too much territory to cover without state securities regulators.

In New Jersey, the Bureau of Securities acts on behalf of the Attorney General. New Jersey is one of only five states to place such an agency directly under the control of the Attorney General. As Attorney General, I have both criminal and civil authority to prosecute securities fraud.

The Bureau has a staff of about 60 people to enforce the New Jersey Uniform Securities Law. The Bureau is funded through fees paid by the regulated community as well as fines and other sums collected in enforcement actions. The Bureau regulates the sale or offer of any security sold into or from New Jersey, as well as firms and persons engaged in the securities business in our state. The primary mechanisms for regulation are (1) registration of securities, firms and agents, and (2) enforcement actions against those who fail to comply with registration or engage in fraud.

Since becoming Attorney General last year, I have dedicated increased staff and resources to the Bureau of Securities in order to handle the workload. I will highlight a few facts and cases that illustrate the scope of the securities fraud problem we face merely in the State of New Jersey.

New Jersey has a large amount of investment activity. It ranks fourth in the U.S. in total

firms and agents registered, behind only California, New York and Florida. The Bureau of Securities registers approximately 2,700 broker-dealer firms, 155,000 agents, more than 2,000 investment advisers, and 12,200 investment adviser representatives. In addition to the large industry presence, New Jersey has the second-highest per capita income in the country, with many people seeking to invest their money to protect and increase it. New Jersey also has an aging population, and many of the elderly are particularly vulnerable to those engaged in securities fraud.

Registration is important to states as it permits state regulators to weed out bad actors and fraudulent or suspect securities offerings. Our Bureau of Securities has the power to deny, suspend or revoke the registration – and consequently the ability to do business in or from New Jersey – of any broker-dealer, agent or investment adviser and to issue a stop order against any securities offering sold in or from the state. In addition, the Bureau Chief has broad investigative powers and the power to subpoena records and compel testimony or other statements under oath. The Bureau conducts examinations of books and records of broker-dealer and investment adviser firms to determine if they are in compliance with New Jersey's Uniform Securities Law.

Another critical component of the Bureau's work is investor education. Bureau representatives regularly conduct seminars for senior citizens and community groups on avoiding securities fraud. In this area, an ounce of prevention truly is worth a pound of cure. There are many people entering the market who don't know what to invest in, how to choose a broker or how to recognize a swindle. We teach basic precautions, such as checking whether

brokers and investments are registered, and realizing that if a deal sounds too good to be true, it isn't true in most instances. State attorneys general and securities regulators would welcome federal assistance in the investor education area, whether in the form of national ad campaigns or grants for state programs.

Finally, the Bureau has a full-time staff devoted to fielding complaints from investors. The Bureau receives thousands of complaints and inquiries each year. Customer complaints are frequently resolved with the Bureau acting as a middleman between the investor and the broker-dealer firms. Those kind of complaints often involve problems with accounts or account statements or with a non-responsive broker. Other complaints are more serious and lead directly to full-scale investigations.

B. New Jersey's Enforcement Efforts

New Jersey has about 200 enforcement cases in the investigative stage at any given time and more than 40 in active litigation. New Jersey is no stranger to major securities fraud cases. A good example is Robert Brennan, the penny stock king who defrauded investors of millions. The high-profile bankruptcy fraud trial which led to Brennan's imprisonment in 2001 was a result of a cooperative effort involving our Bureau of Securities, the SEC, the FBI and the U.S. Attorney's Office. It was a direct outgrowth of two separate civil matters brought by the Bureau of Securities and the SEC. We secured a \$55 million claim in bankruptcy court against Brennan and a \$45 million judgment, which we are working to collect. I want to focus, however, on our

more recent efforts.

New Jersey played a major role in the landmark settlement announced last year between securities regulators and ten top Wall Street firms regarding stock analyst practices. New Jersey was co-chair, with California and New York, of the steering committee for the multi-state task force organized by the North American Securities Administrators Association that investigated the firms. New Jersey also was lead state for the investigation of Bear, Stearns & Co. The case, as you know, brought major reforms to the industry to ensure that stock analysts are not subjected to pressure to report favorably on stocks and bonds of investment banking clients of their firms.

Just yesterday, I announced another major settlement with significant implications for the industry. New Jersey reached an \$18 million settlement with Allianz Dresdner Asset Management and two affiliated companies regarding allegations of a fraudulent arrangement that permitted a large investor to market time more than \$4 billion in transactions in their mutual funds in violation of fund policies and to the detriment of long-term investors. The settlement requires the defendants to implement corporate governance changes to ensure that portfolio managers for their mutual funds function independently of business managers, and that the funds comply with their own policies barring market timing.

In between those milestones, New Jersey has filed eight major securities fraud cases involving, in the aggregate, more than one thousand investors and more than \$160 million in

investments.

While some con artists target small, inexperienced investors, the reality is that wealth and sophistication are no guarantee that an investor won't be defrauded. In February 2004, we filed suit against three men and their companies, including Clover Management Group Inc. of Fort Lee, N.J., that engaged in an elaborate scheme to swindle investors in the United Kingdom out of more than \$55 million. The defendants falsely claimed to offer investments in the defense industry that would provide strong returns while supporting the British and U.S. war effort in Iraq and the worldwide war on terrorism. New Jersey has seized the assets of the defendants, including a \$2 million yacht, bank accounts, luxury cars and a painting by renowned artist Eduardo Arranz-Bravo. The seizures followed cooperative investigations by our Bureau of Securities, federal authorities and New Scotland Yard. The defendants duped sophisticated investors out of huge sums through slick marketing, which included touring investors around a defense industry plant and claiming to be advised by renowned military leaders and financiers.

Elaborate marketing also was involved in the case of Michael R. Casey. We filed suit in December to seek restitution for at least 195 investors who we allege were defrauded of up to \$15 million in a real estate investment scheme run by Casey. We allege Casey set up a complex network of business entities to front his scheme and recruited investors through his tax preparation business and a series of investment workshops held under the name Midas Financial Planning Services Group.

As mentioned above, as Attorney General, I also have the authority to criminally prosecute securities fraud. In June 2003, we simultaneously filed criminal and civil actions against more than a dozen New Jersey companies and their principals for allegedly stealing more than \$80 million from investors. The scheme's principal architect was Thomas Giacomaro, who pleaded guilty to money-laundering charges brought by the Division of Criminal Justice in the Attorney General's Office and federal charges of mail fraud and tax evasion. Among the parties who lost money in the scheme was best-selling novelist Mary Higgins Clark.

A common theme in each of these cases is that the securities sold by the defendants were not registered with the New Jersey Bureau of Securities, as required by law. If the victims had called the Bureau before investing, as we urge all investors to do, they could have avoided their losses. Again, the need for investor education is highlighted.

Another frequent theme in these cases is cooperation between state and federal authorities. That theme can be seen in the Brennan case, the Wall Street stock analyst settlement, the Clover case and the Giacomaro case. State securities regulators and the SEC can accomplish a lot by working together, as our representatives in the North American Securities Administrators Association have been emphasizing in their ongoing discussions with the SEC and their cooperative initiatives. However, another point should not be lost. States also can be extremely effective on their own, as we demonstrated in the Allianz Dresdner case. In a four-month period, we filed and settled a case that addressed a serious industry problem and led to reimbursement of the affected funds. We secured needed reforms, but resolved the case quickly

to avoid a lingering cloud that might harm the funds. Several other states also have shown their effectiveness on this front.

Although I have discussed high-profile cases that in some instances did catch the attention of federal authorities, many of our securities fraud cases – both civil and criminal – would not be pursued by federal regulators, leaving investors without recourse. There are simply too many cases out there, and sometimes the dollar amount of the fraud is not large enough to interest federal securities regulators given their limited resources. The states serve as valuable partners in securities regulation and in recent years have provided early warnings about dangers in the marketplace, sounding the alarm on day trading, penny stocks, micro-cap funds and analyst conflicts.

The bottom line is that the task of protecting investors is too large to be handled by a single federal agency, the SEC. Investors need the protection of state securities bureaus. The task of protecting investors is only going to grow as trends push individuals to deal directly with their retirement costs and as discussions proceed at the federal and state levels about giving people increased control over investment of their Social Security and other retirement funds, beyond 401K, Keough and IRA plans.

We hope that you will maintain if not enhance the authority of state securities regulators. Further, any additional resources you can provide to us will, I can assure you, be money well spent. Investor protection is the key to investor confidence, and investor confidence is the key to

raising the capital that fuels this nation's economic engine. We can make the nation stronger by working together.

Thank you again for the opportunity to testify. I share your concern about this vital issue and stand ready to work with you as you examine and address it in the future. I look forward to answering any questions that you might have for me today.

PETER C. HARVEY
New Jersey Attorney General

Peter C. Harvey was confirmed by the New Jersey Senate as Attorney General on June 16, 2003. By virtue of his actions and accomplishments, he was named Lawyer of the Year for 2003 by the New Jersey Law Journal. It is the first time the Law Journal has bestowed the honor upon any member of the bar. Attorney General Harvey serves as representative of the National Association of Attorneys General (NAAG) to the Executive Working Group for Federal-State-Local Prosecutorial Relations. The Executive Working Group includes Attorneys General, District Attorneys and representatives of the U.S. Department of Justice. Its principal mission is to encourage and enhance federal, state and local law enforcement initiatives. In addition to his role with the Executive Working Group, Harvey serves as Chairman of the NAAG Subcommittee on Gang Violence, and as Vice-Chairman of NAAG's Homeland Security Committee. He is also a member of the NAAG Corporate Responsibility and Securities Working Group. Prior to his confirmation in June, Mr. Harvey had served as Acting Attorney General since February 15, 2003. Previously, he had served as First Assistant Attorney General and Director of the Division of Criminal Justice, having been appointed to both positions by Attorney General David Samson on January 17, 2002.

During his career, Mr. Harvey has served as an Assistant United States Attorney for the District of New Jersey (1986-1989), where he prosecuted cases involving organized crime, narcotics, bank robbery, credit fraud and child pornography. He also served as a Special Assistant to the New Jersey Attorney General (1989-1990), where he was the principal drafter of New Jersey's assault firearms law. Mr. Harvey has been a mediator for the United States District Court in New Jersey and for the New Jersey Superior Court. He also has served on the Lawyers' Advisory Committee to both the United States District Court for the District of New Jersey and the United States Court of Appeals for the Third Circuit.

Mr. Harvey was a law clerk for the Honorable Dickinson R. Debevoise, United States District Judge for the District of New Jersey. He was also a partner at Riker, Danzig, Scherer, Hyland and Perretti, LLP in Morristown, New Jersey where he practiced principally in the areas of commercial litigation, internal corporate investigations and criminal defense in federal and state courts. Mr. Harvey represented businesses and individuals in a variety of cases including banking, trademark, copyright and reinsurance matters.

Mr. Harvey was raised in Tuskegee, Ala. A current resident of Somerset County, N.J., Mr. Harvey received his law degree from the Columbia University School of Law in 1982, and his Bachelor of Arts degree in Political Science from Morgan State University in 1979. He was admitted to the New Jersey Bar in 1989, the New York Bar in 1984 and the District of Columbia Bar in 1985.