Remarks by

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Introduction

Thank you for inviting me to speak at this important symposium. My work has taken me to exciting and far away places, but none quite as exciting – or as far away – as Australia. Once I saw that the government was providing me a business class ticket, I knew I was going on a long journey indeed.

Before I begin my remarks, let me state that the views I express here today are my own and not the official views of the U.S. Securities and Exchange Commission.

As the new millennium begins, we find ourselves hurtling into cyberspace. The Internet has opened a new world for the individual investor. The ease of Internet access, the unprecedented availability of on-line investment information and reduced transaction costs have empowered individual investors to enter the financial markets in record numbers. Approximately one-half of U.S. households invest in our securities markets and about 20% of those investors now trade on-line.

On-line trading is irresistible for many investors. After all, it’s easy to trade on-line. It seems inexpensive and, until the last month or so, it seemed like a "no-lose" proposition. However, the Internet is equally irresistible to fraudsters. We have seen traditional types of fraud and manipulation migrate to the Internet and are beginning to see new types of fraud develop that are unique to the Internet. Even in the absence of fraud, research shows that too many investors are not well informed about such investment basics as transaction costs, margin trading and best execution.

As securities regulators, our responsibility for investor protection takes on added urgency in the electronic environment. We cannot eradicate fraud from the Internet nor protect investors from financial loss. We can, however, educate investors about investing on the Internet. Investors must become better able to evaluate the information they receive over the Internet, not only to avoid fraud, but to make informed decisions to meet their investment goals.

Protecting On-Line Investors

The protection of investors is the primary mission of the U.S. Securities and Exchange Commission. The SEC carries out this mission in many ways, most notably through corporate disclosure, investor education and a rigorous enforcement program. Chairman Levitt has been unique, however, in his efforts to reach out to retail investors. In speeches and town meetings across the United States, the Chairman has encouraged investors in common sense terms to become better informed about investing.

With the growth of the Internet, the SEC has devoted significant fiscal and staff resources to protecting investors from Internet fraud. Chairman Levitt created the Office of Investor Education and Assistance in 1997. The Office of Internet Enforcement, which coordinates the Commission's Internet enforcement activities, was formed in July 1998. Last fall, Congress supplemented the Commission's Internet fraud budget for fiscal year 2000 with a $12.5 million appropriation for the specific purpose of strengthening our Internet enforcement activities. The funds will be used to hire additional staff and automate our surveillance program.

First, let me turn to the enforcement area.

Internet Enforcement Program

The Commission's Internet Enforcement Program is centralized in the Office of Internet Enforcement ("OIE") within the Division of Enforcement. The OIE oversees our "Cyberforce" composed of approximately 250 attorneys, accountants and other staff located throughout the United States. Cyberforce members spend a portion of their work week "surfing" the Internet in search of potential securities frauds.

The OIE also oversees one of the Commission's two on-line customer complaint centers. Receiving an average of 200 hits per day, the Enforcement complaint center has proved an effective source of leads.

The OIE also conducts special projects and sweeps. A sweep is a relatively new enforcement technique involving the simultaneous investigation of numerous individuals, broker-dealers or issuers, with multiple actions being announced on the same day for maximum deterrent effect.

The Internet enforcement staff is seeing three traditional types of Internet securities fraud:

- market manipulations or so-called "pump and dump" schemes;
- offering frauds characterized by promises of unrealistic returns with little or no disclosure of risks and in many cases involving the outright misappropriation of customer funds; and
- illegal touting.

Market Manipulation

Of these three types of fraud, market manipulations are by far the most prevalent on the Internet. In this regard, the Internet has become the boiler room of the new millennium. The on-line "pump and dump" is best exemplified by our proceeding against NEI Webworld, a case that was brought within four weeks of the alleged violations. The company's stock closed on a Friday at 13 cents. Over the weekend, two UCLA students used university library computers to send hundreds of false message board postings over the Internet, stating that the company was to be acquired by another company. Demonstrating the reach and power of the Internet, the stock rose to $15 on Monday, and the defendants sold their stock, making $364,000 in trading profits. However, thanks to the Enforcement staff's quick response, these trading profits were very short-term profits.

Momentum trading is another variation of Internet manipulation. In one recent case, three Georgetown University law students created a website named FastTrades.com, which announced a "stock pick of the week" every Monday morning. The weekly announcement spurred thousands of investors to buy the securities recommended on the website, sending the price soaring. The students then sold their stock into the price increase and made $350,000, again in short-term profits. We charged the students with failing to disclose that they owned shares in the recommended companies and were selling into the price spikes.

A third type of Internet manipulation involves manipulation by spam. In a recent action, we charged two persons with manipulating 57 stocks by the use of spams that contained unrealistic price predictions. The messages were made to look as though they were endorsed by America Online, Inc. by the use of a tagline labeled "AOL Investment Snapshot." The defendants made $300,000 in short-term trading profits.

Offering Frauds

We see new offering frauds nearly every day. Investors are guaranteed stratospheric rates of return and the return of their principal for investing in everything from earthworm farms, to coconut plantations, to prime bank note schemes and various Ponzi schemes. In many cases, investor funds are misappropriated by promoters or used to pay previous investors. The OIE supervised a sweep of offering frauds in May 1999 that resulted in 14 actions against 26 defendants for using the Internet to defraud investors and potential investors. One of the more notorious of these cases was the New Utopia case, a fraudulent $350 million bond offering in which customer funds were raised for the purpose of constructing – on concrete pillars underwater -- a new Caribbean island that would be a tax haven. It sounds crazy, but the site actually received 100,000 hits.

Illegal Touting

The illegal touting cases we've brought exemplify a new breed of Internet promoter. Section 17(b) of the Securities Act of 1933 makes it unlawful to publicize a security for which you are being paid unless you disclose the nature, amount and source of the compensation. A sweep in October 1998 resulted in 23 cases charging 44 individuals and companies that touted stocks without disclosing that they had been compensated by the issuer. A follow-up sweep conducted in 1999 resulted in four more cases. The touters received over $6 million in compensation and more than $2 million shares and options for touting the stock of 235 microcap companies.

New Variations

A new variation of Internet securities fraud cases is the "imposter" case. ***Pairgain*** is a good example of an imposter case. In April 1999, someone posted a message on a Yahoo! bulletin board that said that Pairgain Technologies Inc. would be acquired by an Israeli company. The message contained a link to a phony, but amazingly realistic, Bloomberg web page that repeated the news. The result? Significant trading activity and an increase in price. The case demonstrates how quickly law enforcement can identify and apprehend Internet fraud artists. Less than two weeks later, a Pairgain employee was arrested by the FBI and charged with fraud by the SEC.

We've also brought cases against persons passing themselves off on the Internet as expert stock pickers and selling their advice. In the ***DynamicDaytrader*** case, a website provided real-time daytrading stock recommendations on a subscription basis and claimed a 747% return for calendar year 1999. The main feature of the DynamicDaytrader site was a link to a real-time window referred to as the "Trading Floor" where subscribers could see actual trades done by a daytrader. We alleged that the website was replete with false and misleading information, including the DynamicDaytrader's personal daytrading experience, his claimed performance and the fictitious prices posted for trades, and that the operator of the site was operating as an unregistered investment adviser.

We brought a similar case against Tokyo Joe. Tokyo Joe operated a website that charged subscribers, mostly day-traders, between $100 and $200 per month for stock tips. The website contained a real time chat room in which Tokyo Joe would discuss his recommendations and other investment matters. The SEC charged that Tokyo Joe committed fraud by purchasing securities in advance of recommending them to subscribers and then selling them after his recommendation to subscribers significantly increased price and volume. The SEC also charged that in at least one case Tokyo Joe had accepted stock from one of the issuers he was touting without disclosing it, that the performance data posted on his website included fictitious trades and that he was operating as an unregistered investment adviser. Unlike the ***DynamicDaytrader*** case, which was settled, the ***Tokyo Joe*** case is in litigation.

I could go on and on, but you get the idea. These cases send two messages. To fraudsters, the message is: we have zero-tolerance for Internet fraud. To investors, the message is: Be skeptical of the "get rich quick" schemes prevalent on the Internet. If it sounds too good to be true, it usually is.

Investor Education Program

The other prong of our fight against Internet fraud is investor education. Central to our investor education program is our Office of Investor Education and Assistance ("OIEA"). The office serves investors who complain to the SEC about investment fraud or the mishandling of their investments by securities professionals. The staff responds to a broad range of investor inquiries, produces and distributes educational materials, and organizes town meetings and seminars.

We believe that an educated investor provides the best defense -- and offense-- against securities fraud. Investors who know what questions to ask and how to detect fraud will be less likely to fall prey to con-artists. And, because they are more likely to report wrongdoing to the SEC and their state securities regulators, educated investors serve as an important early warning system to help regulators fight fraud.

The SEC educates investors on how to invest wisely and protect their savings from fraud through a variety of programs, including:

1. Free Publications -- We publish and distribute free publications that describe in plain English how the securities industry works, how to invest wisely and avoid fraud, and where to turn for help.
2. Investors' Town Meetings -- We've participated in 37 Investors' Town Meetings to educate investors and respond to their concerns. We've also organized numerous seminars on saving, investing, and planning for a secure financial future.
3. SEC Website -- The Investor Assistance and Complaints section of the SEC's website at www.sec.gov/invkhome.htm features interactive quizzes and calculators, information about online investing, and a special section for students and teachers. Investors can read and download educational materials and see our latest investor alerts. They can also use the "Search Key Topics" databank to find quick answers to common questions about investing.
4. Toll-free Information Line -- Investors can use our 24-hour, toll-free information line -- (800) SEC-0330 -- to order free publications and get updates on fast-breaking cases.
5. Media Outreach -- We work with national and regional media to ensure that as many Americans as possible hear our investor education and protection messages and learn how to reach us.
6. Investor Assistance -- Our staff of trained investor assistance specialists handle more than 72,000 investor complaints and inquiries each year. Every investor contact provides a unique opportunity to educate the public on a vast array of topics -- such as how to use the Internet to invest wisely, where to find information about companies, and how to obtain a broker or adviser's disciplinary history.

Customers can file a complaint with the office by phone or letter, and many use the office’s on-line customer complaint form. The office refers most of the complaints to the broker-dealers involved and refers complaints involving allegations of fraud to the OIE.

The number of complaints against on-line brokers has increased dramatically over the last two years. During fiscal year 1999, the Commission received over 3,000 complaints against on-line brokers, an increase of close to 200% over fiscal year 1998 and about 1200% over fiscal year 1997. During this three-year period, the number of on-line investor accounts jumped from 3.7 million in 1997 to 7.3 million in 1998 to about 12 million today.

According to statistics maintained by OIEA for 1999, the top six categories of complaints from on-line customers were:

- failures to process/delays in executing orders (568 complaints)
- difficulty in accessing account/contacting broker (566 complaints)
- errors in processing orders (352 complaints)
- "best execution" problems (213 complaints); and
- errors/omissions in account records/documents (133 complaints).

By way of contrast, only one of the top five complaints against off-line broker-dealers – failures or delays in processing orders – could potentially be attributed to technology. The remaining top four complaints were problems with transferring accounts, unauthorized transactions, failure to follow customer instructions and misrepresentations by brokers, all of which presumably involved a human component.

In November 1999, I published a report on trends and issues in on-line brokerage based on roundtable discussions with industry professionals. The report is available on-line at www.sec.gov. The report discussed trends in on-line brokerage and made conclusions and recommendations in the areas of suitability, best execution, market data, systems capacity, investor education, on-line discussion forums and privacy. One of the recommendations of my report was to conduct an investor education survey to find out how investors process the investor education material available to them on the Internet. Having this information will help the Commission determine how and where to devote our investor education resources.

My office is working right now on a questionnaire that will be distributed to customers of on-line broker-dealers that are members of the Securities Industry Association. We are interested in knowing:

1. the sources of financial information that investors rely on in making investment decisions;
2. customer expectations at on-line firms;
3. the level of knowledge and experience of the average on-line investor;
4. the trading frequencies of investors at on-line versus off-line firms;
5. the success of existing disclosures and disclaimers; and
6. how investors analyze risk and the segments of investors most at risk of poor investment decision-making.

We hope to distribute the survey to 2,000 on-line investors this summer. We may publish the results of the survey on the Commission's website.

On-Line Brokerage Policy Issues

Another policy issue raised in my on-line brokerage report was suitability. As you know, the National Association of Securities Dealers, Inc. ("NASD") is the self-regulatory organization for the over-the-counter securities market; it is registered with the Commission and subject to SEC oversight. NASD rules require that a recommendation made to a customer be suitable for that customer in light of the customer's financial situation, objectives and needs.

The NASD has advised its members that transactions that are not recommended do not generally give rise to a suitability obligation. However, given a broker-dealer's technological capability to customize investment information and investment services for on-line investors, it can often be difficult to determine what is a recommendation and what is not a recommendation on-line. In my report, I posed several hypotheticals to stimulate discussion of suitability obligations in the electronic world.

The policy question we are considering right now is whether additional guidance on on-line suitability issues is necessary or appropriate. At this point, the answer depends on whom you're talking to. Full-service broker-dealers that offer on-line trading to their customers accept that they are subject to a suitability requirement and are grappling with how to supervise customers' on-line and off-line activity. Discount broker-dealers that only offer on-line execution services are interested in obtaining clarification that they are not responsible for the suitability of unsolicited transactions effected by their customers, even when such a transaction would not be appropriate for the customer. Competitive issues may force discount broker-dealers to begin offering advice, but there may well be a segment of any broker-dealer's clientele that wants execution services only.

In the meantime, the NASD, NASAA and I are visiting on-line brokerage firms to learn about how they are using technology and the services they are offering their customers. We will consult as to the need for rule-making or interpretive advice from the Commission or the NASD.

Margin

Another policy question that we are monitoring, primarily from a disclosure and investor education standpoint, is margin. In the United States, initial margin requirements are established by the Federal Reserve Board and margin maintenance requirements are set by the self-regulatory organizations – the New York Stock Exchange and the NASD. The Fed's initial margin requirement is 50%, and the SROs' maintenance requirements are 25%. Broker-dealers may impose higher "house" maintenance requirements – typically 30 or 35% -- and many set even higher margin requirements for particular securities.

The rate of margin debt is on the increase and some have called on regulators to raise margin rates. Margin debt accounted for 1.61% of total stockholdings in 1999, the highest ratio since 1994. From September 1999 until February 2000, margin debt increased 48% to $265 billion, and a lot of it appears to have been at on-line brokerage firms. In the aftermath of the market downturn nearly a month ago, on-line firms issued twice as many margin calls as normal, but were forced to liquidate a relatively small number of customer accounts. For example, at one firm, carrying approximately 53,000 margin accounts, only 170 accounts were liquidated – either partially or fully – with an average margin debit of $83,000.

News reports and information from our customer complaint centers indicate, however, that customers may not fully appreciate the risks they undertake when they trade on margin. We received 50% more margin complaints in the first quarter of this year than the last quarter of 1999. Not only are customers surprised at the speed of market downturns, they are alarmed to find that some or all of their holdings may be liquidated to meet margin calls with little, if any, advance notice. The SEC's web site has information on margin trading as do many broker-dealers, but more effective disclosure about the use and cost of margin is clearly needed as well as disclosure about the costs of investing generally.

Leveling the Playing Field for Individual Investors

Since we're talking about individual investors, I wanted to mention some rule-making the Commission is currently considering that will rely on technology to make even more information available to customers at very little additional expense for companies.

Selective Disclosure. The first is selective disclosure. Chairman Levitt is committed to reducing disparities between retail and institutional investors in terms of access to investment information. The Commission is currently considering proposed Regulation FD (Fair Disclosure) that deals with the problem of issuers making selective disclosure of material non-public information, usually earnings-sensitive information, in meetings or conference calls with analysts, institutional investors or others – but not to the public at large. This situation may lead investors to question the fairness and integrity of our markets.

Under the proposal, issuers disclosing material nonpublic information to a person outside the issuer would be required to disclose the information publicly and simultaneously. Where disclosure was inadvertent, public disclosure would be required to be made promptly. The staff is in the process of analyzing the thousands of comments that were submitted in response to the proposal. The vast majority of these comments came from individuals who e-mailed their support for the proposal. The common theme of other commenters, including corporations and securities lawyers, is that the proposal would have a "chilling effect" on corporate communications. These commenters believe that the difficulty of making materiality determinations will make corporate officials cautious about discussing important information.

As I mentioned, the staff is still reviewing the comments. It would be my hope that we will be able to achieve a balance between both views and come up with a solution that will contribute to a more level playing field for individual investors.

Electronic Roadshows. A related issue that involves opening up communications to individual investors is electronic roadshows. Roadshows have traditionally been viewed as oral presentations that are not subject to securities law requirements governing written prospectuses. Prior to a no-action letter issued to Charles Schwab & Co., Inc., last November, issuers were restricted from transmitting roadshows to anyone but the traditional invitees – brokers, institutional investors and investment advisers. The ***Schwab*** letter was the first letter involving transmission of an electronic roadshow to a segment of retail investors. Under the terms of the letter, an underwriter could give access to an electronic roadshow to a class of Schwab's customers meeting certain net worth and frequency of trading standards.

The staff recently supplemented the ***Schwab*** letter to clarify that underwriters cannot develop two different versions of the roadshow – a full-bodied version for traditional institutional audiences, complete with earnings projections and other material information often presented at roadshows, but not included in the prospectus, and a watered-down "roadshow lite" version for retail investors that consists primarily of management interviews.

The ***Schwab*** letter has drawn both praise and criticism. Some have applauded the letter as a significant step towards democratizing access to roadshow information, while others have criticized it for not opening roadshow access to all types of retail investors, regardless of their net worth and level of financial sophistication. Still others have expressed concern that individual investors who are not financially sophisticated may find it difficult to separate marketing hype from the offering fundamentals.

Because the staff seems to be at the outer bounds of what it can do about roadshows through no-action letters, the Commission plans to address roadshow issues through rulemaking. Of course, leveling the playing field by opening roadshows to all investors includes risks as well as rewards. There is the potential for creating a very flat field with diluted roadshow content. As we move forward, we must recognize that liberalizing roadshow procedures will likely result in investors receiving new types of information – information that they may not be able to evaluate. This is another reason why investor education will play such a critical role in the technology era.

On-Line Initial Public Offerings.

There is also an investor education component to the current popularity of on-line IPOs. Many on-line broker-dealers are using the Internet to offer and sell securities in initial public offerings. About a dozen firms have begun distributing a small, but growing, percentage of shares of IPOs to retail investors with on-line brokerage accounts. During the last half of 1999, approximately 3% of all IPO shares went to on-line investors. About 38% of IPOs had an on-line distribution component and approximately 6% of the shares offered in these IPOs were sold to on-line investors. Our Division of Corporation Finance has evaluated broker-dealers' electronic offering procedures with respect to electronic access to the prospectus, the timing of online sales of securities (pre-effective sales violate the securities laws) and the funding of electronic brokerage accounts. The Division informally requires that electronic offering procedures provide for disclosure of the risks of on-line investing, including the risk of system outages, the risks of purchasing IPOs as well as the possibility that customers may not receive an allocation.

Conclusion

I hope my quick summary of our enforcement and investor education programs and some of our rule-making initiatives has been informative. I want to conclude with one additional thought about combating Internet fraud. Australian and U.S. securities regulators worked cooperatively in a recent case of cross-border Internet fraud in which two Australian residents falsely touted the stock of Rentech, Inc., a U.S. company, in millions of e-mails spammed to individuals worldwide and on various Internet message boards. The alleged touting caused the price of the stock to double from $0.45 to $0.875, enabling the two individuals to sell their shares at a profit.

This case sends the message that, regardless of residency, individuals cannot use the unlimited access of the Internet to defraud investors and demonstrates the effectiveness of international cooperation among securities regulators. It also raises many questions for securities regulators about the potential depth and breadth of the global securities markets. But I'll save those questions for another day.

Thank you.