

## 1 QUESTION AND ANSWER: SECURITIES/FUTURES EXCHANGES

2

3 CHAIRMAN JAMES: I'd like to open it up for  
4 discussion at this time. I'll start down here with Commissioner  
5 Bible.

6 COMMISSIONER BIBLE: For Dr. Ruder, how does the  
7 securities industry police its advertising practices to make sure  
8 that its advertisements are not marketing to people who may not  
9 be financially able to undertake that kind of an investment? I'm  
10 thinking of Money magazine being available, all the ads in the  
11 Wall Street Journal, things of that nature.

12 MR. RUDER: The sales literature which goes out from  
13 a brokerage firm to its customers is carefully regulated by the  
14 NASD. The brokerage firm is required to look at that sales  
15 literature to see that it does not contain misleading statements.  
16 There are very strong disciplinary actions enforced by the SEC  
17 and the NASD against misleading sales literature. There is no  
18 general requirement dealing with advertising in that same sense,  
19 but again, a brokerage firm would not be advertising in a  
20 magazine or newspaper in a way which violated those sales  
21 literature requirements.

22 COMMISSIONER LEONE: Can I just make a comment, that  
23 one of the other differences with regards to the regulatory  
24 structure is that people can bring action based on having been  
25 misled or not having been fully informed of the risks. And  
26 companies, not just individuals, institutions can recover damages  
27 and recover money. So the fact that there is a body of law and a  
28 recognized procedure provides another deterrent for people who  
29 might be inclined to slip something by the SEC or by the

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1 securities dealers or others. These kinds of cases on any given  
2 day, I wouldn't guess how many of them are floating around.  
3 They're not uncommon. They're common. There are mostly  
4 settlements and other things. But in addition there are  
5 arbitration procedures so that they don't go to the Courts.

6 In other words, there are sanctions beyond just those  
7 by the organizations or by regulatory authorities. It's a well  
8 recognized right the investor has or a speculator even to recover  
9 -- actually the speculator is a better example in this context --  
10 if they weren't properly informed of the risks, when those  
11 requirements are in place for that particular person, whether  
12 it's an individual or an institution.

13 CHAIRMAN JAMES: Would either of you know of any  
14 particular data that exists on how effective disclosures have  
15 been in terms of screening out those individuals who may have  
16 gotten themselves in trouble?

17 MR. RUDER: I don't know that there is a set of  
18 statistical data justifying the disclosure system. It is so well  
19 accepted in the securities industry that the SEC has developed an  
20 entire apparatus around it; that is, the disclosure of  
21 information regarding companies. Every public company is  
22 required to disclose annually practically everything about them.

23 CHAIRMAN JAMES: Not only that, but disclosing risk,  
24 potential risk.

25 MR. RUDER: I don't know of any statistical analysis  
26 of that, although the ad hoc experience is that in the so called  
27 penny stock area there has been tremendous over-reaching with the  
28 result of both legislative and administrative reform efforts.

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1 MR. HARRIS: I don't know of any statistics.  
2 Periodically the disclosure system is subject to review and there  
3 have been through modern times severe critics of the entire  
4 disclosure system on the simple grounds saying that this kind of  
5 information would get out under any circumstances and that it is  
6 really unnecessary for government to enforce the kind of  
7 disclosure standards that they have. As David points out, the  
8 general prevailing wisdom is, I think, that disclosure is  
9 beneficial and at least it's not in any way hurtful. Whether in  
10 fact, to just look at that pamphlet on the options market,  
11 whether in fact investors do read the 35 pages of the risks  
12 associated with investing in options or if those that do needed  
13 to read it to begin with, I don't know. One has to question  
14 whether in fact one needs 35 pages to tell someone of all of the  
15 risks that are involved in a particular activity, and if you do,  
16 whether that's going to be effective. That's as far as I could  
17 go.

18 CHAIRMAN JAMES: Perhaps just because it's 35 pages  
19 ought to send signal enough.

20 Commissioner Wilhelm and then Commissioner Dobson.

21 COMMISSIONER WILHELM: I very much appreciate the two  
22 of you coming here. I appreciate Commissioner Leone helping  
23 arrange this. I have either the advantage or disadvantage of  
24 being a complete lay person in all of this. I don't gamble in  
25 the markets, nor do I gamble in casinos. But I must say that as  
26 a lay person as well as a representative of workers, it seems to  
27 me -- I certainly wouldn't argue with your last statement, that  
28 at least all this disclosure stuff is not hurtful, or at least I  
29 think it wouldn't be. It could be hurtful if it leads people to

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1 believe that everything is kind of protected and it really isn't.  
2 But I would think, for some of the reasons you just cited, that  
3 there are not a whole lot of people who actually understand the  
4 degree of risk to which they are subjecting themselves because  
5 the disclosures are so complicated. I wouldn't have gone so far  
6 until my expert friend to my left said earlier that on the Brady  
7 study they discovered that people in high ranking positions in  
8 the securities field didn't understand the risks either. I  
9 didn't know that. That's a somewhat stunning statement.

10           If all of that disclosure works, I would have thought  
11 that at least the people running the system would have understood  
12 it. I'm not trying to be facetious. When you just look around  
13 as a lay person, the people of Orange County are about to pay \$2  
14 billion because of derivatives. I bet you there's not 1,000  
15 people in America who can explain derivatives accurately.

16           CHAIRMAN JAMES: And two of them are here.

17           COMMISSIONER WILHELM: Well, two of them are probably  
18 here. Millions of people in California and probably other states  
19 buy things called guaranteed investment contracts to protect  
20 their retirement which is not remotely guaranteed. Workers, as  
21 Commissioner Leone observed, a lot of the funds in which workers'  
22 money is invested trail the indexes all the time.

23           So I'm puzzled by what it is that disclosure actually  
24 accomplishes other than possibly a false sense of security. I  
25 would suggest as a lay person the possibility that people who  
26 gamble in gambling places, as distinguished from gambling in  
27 commodities -- again, I'm stunned when Commissioner Leone says  
28 the overwhelming majority of individual investors lose money in a

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1 commodities market. That's an amazing statement. I bet you most  
2 of them don't know that, despite the disclosure rules.

3 I think actually people would go into gambling  
4 establishments of the kind where this Commission talks about,  
5 probably do have a much better idea of the odds than people in  
6 the markets. I think people know that they're probably not going  
7 to win. I think most of them don't have a statistical  
8 understanding of the odds but I bet you that they have a general  
9 idea that they're probably not going to win, at least as much as  
10 people who go invest in the kind of markets you're talking about.

11 With that kind of background, here's my question.  
12 Given the enormous amount of mistakes that happen and money that  
13 is lost in spite of all of these disclosure rules and given -- if  
14 I'm right, and if you disagree please say so -- given that the  
15 majority of individual investors probably don't actually  
16 understand the risks despite all these securities rules and  
17 apparently people that run the business don't either, according  
18 to Commissioner Leone, I wonder if a form of regulation that  
19 looked into the suitability issue and skill and integrity of the  
20 people who run the markets and the investment firms, which is the  
21 kind of regulation gambling has, might not be at least as  
22 effective.

23 MR. HARRIS: First, a couple of things to just put  
24 this in context. First, I think when Commissioner Leone said  
25 that most individual investors lose money, he's talking about the  
26 commodities market, not the securities market.

27 COMMISSIONER WILHELM: Yes, I said that.

28 MR. HARRIS: So it's important to recognize that when  
29 people are in the stock market, when they're buying stock, normal

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1 stocks and bonds, what people have put their pension savings in  
2 or their retirement accounts in or invests in, most people don't  
3 lose money. Most of the disclosures that we've been talking  
4 about with respect to the risk in that market, I think are well  
5 understood and have been very effective.

6 There are what I would call relatively new kind of  
7 investment or speculative products which I've been trying to call  
8 your attention to, which are the options and futures and these  
9 derivative products. I think it's important to recognize that  
10 all of those products are relatively new on the scene.

11 We're trying from a regulatory point of view to get  
12 our hands on those. I think that probably people will have to  
13 lose money before their risks are fully understood and get out  
14 generally known. I think you're right that people understand  
15 when they go into a gambling casino, they may not know exactly  
16 the odds, but they certainly know the odds are against them.

17 I think that people generally are beginning to learn  
18 the complications and odds that are associated with options or  
19 futures or derivatives. But I think it's unfair to suggest that  
20 the regulations have been ineffective or not useful, largely  
21 because these products are so new and so complicated that we're  
22 just learning how to regulate.

23 MR. RUDER: Could I respond in a slightly different  
24 way? The disclosures to investors are effective because this  
25 information gets out into the marketplace and financial analysts  
26 read it. There is a good system for transmission of valuation of  
27 particular stocks that comes through the recommendations made by  
28 financial analysts.

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1           What strikes me in the gambling industry is that  
2 there is information about the odds of any particular gambling  
3 instrument which is available to the people who are selling the  
4 product. I heard this morning on the radio as I was coming down  
5 that Powerball has a \$175 million jackpot and that people all  
6 over the area are racing to invest and one of the statements made  
7 was do they realize that their chances of winning are one in 80  
8 million. Well, they probably realize the chances are small. To  
9 me, if that information is available, it ought to be disclosed to  
10 the potential buyer.

11           If the odds at the craps table are a certain kind or  
12 the blackjack table are a certain kind or at any other form, slot  
13 machines or any other form of gambling, I don't see why the  
14 gambler couldn't be told that the chances of getting a certain  
15 amount of money back for every dollar put into one of these  
16 gambling areas is such and such, 80 percent or 60 percent or 30  
17 percent, whatever it might be. Then at least those people would  
18 have some idea of what they were risking when they were gambling.

19           COMMISSIONER LEONE: Let me just make a point here to  
20 clarify something. There is not decisive but compelling and  
21 consistent evidence that small investors over-estimate the risks  
22 of the stock market and invest more conservatively than is in  
23 their own interest. I won't go into a lot of the factors in  
24 that, but I think that there is evidence that the risk in the  
25 stock market, in fact, for a variety of reasons, is in people's  
26 heads as greater than it is, although it's obviously real.  
27 Whether that's a result of disclosure or the rules or whatever, I  
28 don't know. And this is why the Treasury Department is  
29 interested in our looking at bankruptcy.

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1           There's also some serious thought being given by some  
2 serious academics to whether gambling as an alternative to  
3 investing is reducing savings and investment, which is  
4 paradoxical, because I don't think it's because people don't know  
5 that gambling is more risky than the stock market. But it's  
6 plausible that if one were confronted by two highly risky  
7 investments, one of which paid 80 million to one and the other  
8 one might grow ten percent in the next three years, that you  
9 might be tempted to take a riskier course with your discretionary  
10 money. I don't know.

11           Anyway, I think that the reason this is important is  
12 that we do know that disclosure affects behavior by people in the  
13 industry and by their customers, and suitability affects both.

14           CHAIRMAN JAMES: Commissioner Dobson.

15           COMMISSIONER DOBSON: Dr. Ruder, I saw that same news  
16 story on NBC this morning and was amazed by it. One in 80  
17 million odds and yet people were lined up at 4:30 and 5:00 in the  
18 morning to buy a Powerball ticket. It's obvious that disclosure  
19 has not had much of an impact on those folks.

20           But let me make kind of a general statement and ask  
21 either of you to comment on it. Maybe I'm stating the obvious  
22 from what you said, which I really appreciate and found  
23 informative. As the federal government has a responsibility and  
24 interest in protecting the uninformed, the unqualified, the  
25 ignorant, the mentally deficient, those who might be exploited  
26 through inappropriate investment, if that's at one end of the  
27 continuum where government takes an interest in protection of  
28 individuals, the lottery seems to me at the other end of that  
29 continuum where government profits from exploiting those same

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1 people. It's the opposite approach to the individual who is a  
2 sucker perhaps, those not able to sustain that kind of  
3 investment. Is that a correct assumption?

4 MR. RUDER: I would join your assumption there,  
5 although if you look at the lottery, one is really talking about  
6 a form of taxation. The people who are placing their money in  
7 the lottery are doing so in a situation in which a portion of  
8 that money is going back to the very state who are conducting the  
9 lottery and to the municipalities who are reaping benefits from  
10 it.

11 But it seems to me that there is some room for  
12 protection at least to disclose to the people what the odds are  
13 that their lottery bet will be successful.

14 On the other extreme, I just want to point out that  
15 in the securities industry the primary tool is disclosure. The  
16 suitability doctrines have been invoked primarily in situations  
17 in which someone is recommending the purchase of a security, so  
18 that there's no blanket prohibition against people engaging in  
19 risky stock purchasing or even pseudo gambling activities in the  
20 stock market. But what there is, is prohibitions basically  
21 against somebody recommending this activity to somebody who is  
22 not capable of bearing the risk. That's the area that I think  
23 you really ought to be looking at a little bit at least.

24 COMMISSIONER DOBSON: Is it a stretch to say that  
25 lottery advertising sponsored by the state is in fact a  
26 recommendation?

27 DR. RUDER: I believe it is. I may be more radical  
28 on this view but I believe that the advertisements for lotteries

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1 in this state, the ones that I hear, are totally one-sided. They  
2 advertise all the benefits and none of the risks.

3 CHAIRMAN JAMES: Commissioner Wilhelm.

4 COMMISSIONER WILHELM: I had a non-monetary bet with  
5 myself, how long it would take Powerball to come up this morning.  
6 I must say I do not understand the theory that there's something  
7 reprehensible about a person spending a buck on the chance they  
8 might get hit by lightning as distinguished from a cup of coffee  
9 or a New York Times or something like that. Everyone has their  
10 own little ways of spending a buck.

11 I wish I had time to engage you in more debate here  
12 about things, for example, like Orange County which continues to  
13 amaze me. We don't. So I wanted to ask you a question that  
14 might potentially help us with your experience on the subject we  
15 want to look at tomorrow which is Internet gambling which is  
16 exploding, gambling of the kind that we're studying, not the kind  
17 that you study.

18 I have read some anecdotal accounts of extraordinary  
19 movements in the stock markets, especially the penny stock  
20 markets, driven by, quote, "information," unquote, that is  
21 broadcast on the Internet in ways that are completely unregulated  
22 and come from whoever chooses to put the stuff up there.

23 I wondered if there's anything that either of you is  
24 aware of that relates to the question of regulation and  
25 disclosure about market information on the Internet that might  
26 have something to do with our concerns as a Commission about  
27 gambling on the Internet, either the difficulty of regulating it  
28 or some other aspect of it.

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1 MR. RUDER: We both have an answer, but I'll let Al  
2 answer first.

3 MR. HARRIS: Quickly, it is regulated in both the  
4 securities and futures area but having said that, I think your  
5 last statement is the most important. It is very difficult to  
6 regulate it. Just because it's on the Internet doesn't mean that  
7 it is subject to different rules with respect to fraud or  
8 disclosure or advertising that David mentioned. Those rules are  
9 there. What is difficult for both the CFTC and the SEC is to  
10 identify who it is that may be responsible for putting things out  
11 on the Internet and to finding them, stopping them or otherwise.

12 The SEC has a very, very active fraud team working on  
13 Internet fraud and puffery of stocks and those kinds of issues.  
14 I think that new medium is just simply one in which both of those  
15 agencies are trying their best to get their hands around. But  
16 it's not because they don't have authority or jurisdiction or the  
17 rules don't apply.

18 MR. RUDER: That's exactly right. The SEC has some  
19 20 people scanning the Internet every day to look for fraudulent  
20 and misleading advertisement. We're just looking at a different  
21 medium for what goes on every day in the country, and that is  
22 that there are very, very greedy dishonest people who are trying  
23 to take advantage of the citizens. And the SEC and the CFTC are  
24 both attempting to protect against that activity.

25 CHAIRMAN JAMES: COMMISSIONER McCARTHY.

26 COMMISSIONER McCARTHY: Professor Ruder, could I just  
27 quickly go through your three recommendations? We've touched a  
28 little bit on the first one regarding disclosure and I was trying  
29 to think of what kinds of disclosures might be appropriate.

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1 Certainly the odds. The state run lotteries ought to be at least  
2 saying what the odds are on winning or not, although I think  
3 everybody has a general sense. In something like the lottery,  
4 the odds indeed are very, very long. But it still could be  
5 useful.

6 I was thinking in a casino you could probably hand  
7 material to somebody that would say if you play the blackjack  
8 table, the odds on this kind of a bet are 50 percent, this kind  
9 two percent, whatever it might turn out to be.

10 Now, what other kinds of disclosures occur to you  
11 that might be appropriate for the different forms of gambling?

12 MR. RUDER: My own view would be that they would be  
13 quite general. There would be one quite generalized disclosure  
14 that said you should understand that this is a risky business and  
15 that the odds are that for every dollar you put in you will  
16 receive less than a dollar. Then in cases where that information  
17 is known about a particular activity, you include that.

18 The SEC has a booklet for investors which it  
19 recommends be given to investors which contain a lot of general  
20 advice about investing and what you should know before you  
21 invest. That kind of pamphlet could be prepared and made  
22 available in the gambling establishments.

23 COMMISSIONER McCARTHY: As I understood the earlier  
24 conversation, you suggested that good disclosure information has  
25 some efficacy. I'm going back now to the exchange between you  
26 and my friend John Wilhelm over there. But disclosures also have  
27 much more meaning if indeed there is some governmental entity to  
28 enforce any kind of serious violation of the disclosure  
29 requirements, and that's why the SEC is as I think you both

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1 referred to earlier, is effective. You have some standards. The  
2 disclosure sets some standards for conduct by those running the  
3 gambling, whether it's a race track or lottery or casino,  
4 whatever it might be and if those standards were at least  
5 blatantly infringed, then a lawsuit might be brought. That's  
6 what works coupled with the disclosure. Is that what I heard you  
7 say earlier?

8 MR. RUDER: I think you need to distinguish between  
9 fraud and misrepresentation, that is, lying which is actionable  
10 under the laws of most states under the general law and the  
11 failure to make a disclosure which is required to be disclosed.  
12 That's usually not something which the private citizen can  
13 enforce. So you need some agency.

14 I may just point out that we have state securities  
15 regulators who enforce state laws in the securities area as well  
16 as the federal.

17 COMMISSIONER McCARTHY: Turning to your second  
18 recommendation, don't allow gambling activities to advertise to  
19 prospective gamblers who can't bear financially any kind of  
20 serious loss. How would you define a person who cannot bear a  
21 financial loss? What even general criteria at this point? How  
22 would you get at that? How would the gambling establishments  
23 know that unless of course they have a credit line with the  
24 facility or they often use their credit card facilities?

25 MR. RUDER: The best I can do in that regard is by  
26 analogy to what we call the intra-state offering in the  
27 securities area in which offerings can only be made lawfully to  
28 residents of a particular state. In those cases the  
29 advertisements say this offer for the security is made only to

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1 the residents, say, of Illinois and not to others. It is to me a  
2 very difficult question to figure out who you would advertise to  
3 and who you would not, but I could imagine some kind of  
4 advertisement that included cautionary language that said this  
5 activity is harmful to your financial health and you should be  
6 aware of that if you are planning to engage in the activity.

7 COMMISSIONER McCARTHY: Now, the third recommendation  
8 you make, consideration should be given to finding ways to  
9 protect those who are either financially unsophisticated or  
10 unable to bear the risk, such as restricting access to gambling  
11 establishments. How would those who manage gambling  
12 establishments be able to identify such people?

13 MR. RUDER: I don't have great detail about this, but  
14 the English system requires a membership in the gambling  
15 establishment in order for the person to be able to enter the  
16 establishment. And presumably there are some criteria for  
17 membership which would allow the gambling casinos to screen those  
18 people that didn't meet those standards.

19 COMMISSIONER McCARTHY: Thank you. One final  
20 question, not about your recommendations, but something that's  
21 been concerning me as we went through these meetings is how  
22 credit is handled with people. We're studying pathological or  
23 problem gamblers, people for whom it's a compulsion or an  
24 obsession to gamble. The fact that there are credit card  
25 machines just a few feet away from the gambling tables and so on,  
26 make it easier, that there are indeed now publicly traded  
27 companies dealing in the credit card market with a number of  
28 gambling establishments. So it's gone big time.

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1           Do you have any thoughts about how you would try to  
2 control the irresponsible extension of credit? I'm not citing  
3 any particular case. I noticed that the Illinois Gaming Board --  
4 we're going to hear this in other testimony -- fined a casino in  
5 this state \$100,000 for improper extension of credit. Do you  
6 have any thoughts about how we get at that? So much gambling is  
7 done on credit and we've heard testimony in Atlantic City and I  
8 think in Boston that people have gone bankrupt using a number of  
9 credit cards. Do you have any thoughts in this area?

10           MR. RUDER: I don't have any specific thoughts. I  
11 will tell you that in the New York Stock Exchange rules they have  
12 something called the know your customer rule. The know your  
13 customer rule is one form of the suitability doctrine that we've  
14 been talking about, but it's also important to know your customer  
15 to know his or her credit so that the brokerage firms know their  
16 customer in the sense that they know their customer will pay.  
17 That's very important for the brokerage industry because we do  
18 not want to have a market in which there are great defaults.

19           I think you're talking about something quite  
20 different when you're talking about the credit of those who  
21 gamble.

22           CHAIRMAN JAMES: Commissioner Lanni.

23           COMMISSIONER LANNI: Thank you very much. A couple  
24 of comments actually and observations. One, if I could,  
25 Professor Ruder, relative to the United Kingdom, in London there  
26 are private clubs and that is a membership requirement. Outside  
27 of London, they have a number of larger casinos and there's no  
28 requirement for membership. So it's a dual situation for either  
29 the private membership in clubs as they call them which are

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1 casinos, but very small ones in London itself. But outside in  
2 other areas of the United Kingdom they have larger casinos which  
3 do not require any membership.

4 One aspect I notice -- and I think disclosure is a  
5 very important factor. But unfortunately we're in such a  
6 horrifically litigious society it seems to me that disclosures  
7 are written by law firms, with maybe 50, 60 different lawyers  
8 working together to come up with a 95 page pamphlet. How many  
9 people really take the time to read this? Is the purpose of this  
10 probably more I would think for the protection of the entities  
11 issuing these investments rather than for the protection of the  
12 individual? Sometimes a simple one page summary which you then  
13 can follow up with detail might be an observation that I would  
14 suggest would be a better way of disclosing the risks.

15 I might add also that on commodity futures, when you  
16 take a look at -- regardless of one's position relative to casino  
17 gaming or pari-mutuel wagering or lottery purchases, one  
18 significant difference between commodity futures and those forms  
19 of gaming that I just suggested, the other forms of gaming,  
20 whatever you wager is the most that you can lose. There is  
21 disclosure. I noticed in Mr. Harris' exhibit C, relative to the  
22 fact that you can lose more than your investment in commodity  
23 futures.

24 I'm not so sure that the casual investor is quite  
25 aware of that until that unfortunate occurrence may take place  
26 when they receive a call saying the \$500 that you invested is  
27 gone, and by the way, you owe us another \$2,000. That can  
28 confuse a lot of people.

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1 Another observation that I have and it's something  
2 that I have learned over recent years is that a number of  
3 companies in the United States cannot find themselves  
4 sufficiently capable of being listed on an exchange in the United  
5 States, seem to go to an area in Canada called Vancouver. The  
6 Vancouver Exchange, at least anecdotally, is an exchange that has  
7 less than responsible requirements for participation in that  
8 exchange. There're great, at least anecdotally, a lot of  
9 allegations that there are sufficient misrepresentations,  
10 defaults, game playing, what have you in that exchange.

11 I am bothered when I notice in the disclosure that  
12 the United States regulatory system has no control over these  
13 exchanges, whereas individuals representing brokerage firms in  
14 the United States have the ability to sell securities on an  
15 exchange such as the Vancouver Exchange. Again I say  
16 anecdotally, has some very difficult aspects to it that concern  
17 people.

18 Has the United States ever suggested that they would  
19 have some ability to cooperate, for example, with the Canadian  
20 authorities, the equivalent of the Securities Exchange  
21 Commission, to have some form of influence in the regulation or  
22 at least exposure of possibly the difficulties that exist there?

23 MR. RUDER: There is considerable cooperation between  
24 the various securities commissions of world -- there's an  
25 organization called the International Organization of Securities  
26 Commissions in which the regulators meet frequently to discuss  
27 what can be done. The United States has, however, decided not to  
28 attempt to engage in what might be called extra-territorial  
29 regulation. If someone is stupid enough to go an unregulated

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1 area in order to risk their money and that area is outside the  
2 United States, the SEC at least has said, well, we've done all we  
3 can to protect that person. As long as I have a chance, I would  
4 say one of the reasons that our capital markets in the United  
5 States are so wonderful is that we have had this tremendous  
6 disclosure and regulatory system which provides a system in which  
7 our citizens can count on the integrity and honesty of the  
8 system.

9 MR. HARRIS: Could I just make one point about  
10 Vancouver, whether it is as bad as the anecdotal evidence  
11 indicates or not. If a broker in the United States were to seek  
12 to sell stocks in a Vancouver listed company to a United States  
13 citizen in the United States, all of the same protection would  
14 apply. That is, the suitability rules would be applicable.  
15 There would be questions as to the advertising or otherwise. So  
16 that the standards there, and indeed even the penny stock  
17 requirements that we now have with disclosure would be applicable  
18 to those sales. It's not as though when those securities come  
19 into the United States for sale they are totally unregulated.

20 COMMISSIONER JAMES: I will let you close out our  
21 time together.

22 COMMISSIONER LEONE: If I'm closing it, I want to say  
23 this has been superb testimony and I think provocative. I think  
24 it will -- I hope it has some influence over the way we think  
25 about some of these issues. I want to raise two points.

26 One is that we should come back to the credit issue  
27 because it is significant and it is quite different in the  
28 securities industry, the disclosure statements that people have  
29 to fill out in order to -- and institutions to be in certain

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1 markets require you to have bank references. In addition, even  
2 in the futures market you have to put up initial margin beyond,  
3 which has to be in the form of treasury bills normally. So  
4 you've already put money in place. You have to do that in the  
5 stock market. In those markets there is a tremendous pressure on  
6 the intermediary to make sure your credit is good because the  
7 exchanges have recourse to the clearing members.

8 In other words, it isn't the individual's credit that  
9 will determine whether or not a big move in the market gets  
10 settled. The clearing member will have to come up with the money  
11 so they have a great interest in knowing their customer for  
12 reasons that are self-serving which is often a good way to get  
13 the right motives.

14 And finally in the area of disclosure, although this  
15 is a little apart from the testimony, I do want to mention it  
16 because I think it's very relevant to the specific example of  
17 lotteries we were talking about. Right now, lotteries are not  
18 only advertised as a way to get rich quick, they're justified in  
19 part as a way to pay for education or to pay for senior citizens,  
20 to pay for poor or crippled children. All of the serious  
21 studies, and we have a very good one from the Controller of the  
22 State of New York, demonstrate that not surprisingly, because  
23 money is fungible, there is virtually no evidence that there's  
24 increased spending in total on any of these things in any of  
25 these states. This tax simply replaces other tax. That would be  
26 a fact that ought to be disclosed. That would be a disclaimer to  
27 the claim that the money is being spent for these good purposes  
28 that in fact, studies show that there's no increased spending.

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1           The second thing is -- and I think this might have an  
2 interesting effect in our society on behavior on lotteries. The  
3 disclosure of the fact that lottery purchases are taxes at an  
4 effective rate of 70 percent, 75 percent, 80 percent, 85 percent  
5 depending on what it is state by state, would I think be a jolt  
6 to most citizens. I don't think people want to buy too many  
7 things that have an 80 percent tax attached to them, and I don't  
8 think most people realize is that is how large the effective tax  
9 rate is on lotteries.

10           So when you get into disclosure in these areas, there  
11 are other things that it would be useful to have out there that  
12 don't necessarily mirror the securities industry. But this has  
13 been, as I said, extremely useful and we really appreciate it.  
14 Probably we won't have a more distinguished panel no matter where  
15 we go and who we talk to.

16           CHAIRMAN JAMES: That certainly is the case. I'd  
17 like to thank both you gentlemen for being here this morning. I  
18 assure you that you will see your testimony quoted from  
19 vigorously as we go throughout our process. It's been a  
20 fascinating discussion and we appreciate you taking your time to  
21 be here and share your insights with this Commission this  
22 morning.

23           MR. RUDER: Thank you very much.

24           MR. HARRIS; Thank you.

25           CHAIRMAN JAMES; You're more than welcome. The  
26 Commission is going to stand in recess for approximately 15  
27 minutes. I think everybody needs it at this point.

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