THE HONORABLE DAVID RUDER, FORMER CHAIRMAN, SECURITIES AND
EXCHANGE COMMISSION

CHAIRMAN JAMES: I'd like to begin with you, Mr. Ruder.

MR. RUDER: Thank you very much, Dean James. It is a pleasure to be here.

The securities markets and gambling share certain characteristics. Both involve uncertainty regarding outcome. For a gambler this uncertainty is frequently quantified as the odds that their certain bet will be successful. For an investor the uncertainty is whether the market will value the investment at a higher or lower level over time. Thus, both investing and gambling involve risk.

The primary distinction between gambling, as Mr. Leone pointed out, and investing is that an investor purchases an ownership right in a document that has underlying value, such as stock, while gambling only involves the right to require another to meet an obligation to pay. Both gambling and investing involve a variety of products.

Gambling may involve many different activities including card playing, dice throwing, horse racing, lottery. Investing may involve the purchase or sale of many different securities, stocks and bonds and more complicated derivative securities.

The Securities and Exchange Commission regulates investing. It does so by regulating the distribution and trading of securities directly, and with the help of so called regulatory organizations, the stock exchanges and the National Association
of Securities Dealers. The SEC oversees these SROs by approving
their rules, inspecting them and occasionally imposing
disciplinary sanctions on them.

The Securities Exchange Act of 1934 requires all
brokers and dealers to register with the SEC and become members
of the NASD or the Securities Exchange. The SEC then adopts
rules, governing the conduct of brokers and their associated
persons and the exchanges in the NASD also adopt rules relating
to the conduct of their members.

Several aspects of the securities law regulating
distribution of securities offer important insights for the
gambling industry. When corporations sells securities to the
public, they are asking investors to believe that future
prospects for the corporation are good. The primary protection
offered by the federal securities laws is disclosure, rather than
evaluation of the merits of proposed investments. The theory is
that once investors are fully informed, they should be able to
bear the risks and reap the rewards of their investment
judgments.

The primary device used by the SEC to assure fair
disclosure is to require that corporations selling securities
prepare and distribute a prospectus containing the disclosures.
One of the disclosures involves risk factors involved in the
offering. I might just read this regulation in part that governs
this. It requires inclusion of the discussion of the principal
factors that make the offering speculative or one of high risk.
These factors may be due, among other things, to such matters as
an absence of operating history of the registrant and the absence
of profitable operation in recent periods, the nature of the
business in which the registrant is engaged and proposes to engage or the absence of a previous market for the registrant's common equity.

I was not asked to make recommendations to you, but I'm going to do so anyway. I believe that the disclosure protection of the securities laws provide an excellent model for gambling. Those conducting gambling activities should be required to make adequate disclosures about the risks of gambling, including a general warning about the risks of gambling and specific disclosure of the odds applicable to each form of gambling.

A second area of protection involves investor sophistication. When corporations choose to sell securities without registering them, the SEC provides protections to those who are buying the securities. The assumption is that certain investors, called accredited investors, are sophisticated enough to seek ample disclosure before investing and sophisticated enough to understand the significance of information disclosed to them. Accredited investors are defined by the Securities and Exchange Commission to include officers and directors of the corporation whose securities are being offered, banks, natural persons with considerable wealth, net worth exceeding $1 million.

However, in one of its exemptive rules, the SEC recognizes that persons who are not in this category, non accredited investors, may not be financially sophisticated and requires that each person who is not an accredited investor, either alone or with a purchaser representative, has such knowledge and expertise in financial and business matters that he
is capable of evaluating the merits and risks of their perspective investment.

This emphasis upon the ability to understand risk also provides a good model for the gambling industry. Those who conduct these gambling activities should be prevented, in my opinion, from directing advertisements to persons who do not have the sophistication to understand gambling risks.

A third area of protection for investors is under the doctrine of suitability. The NASD requires their members and registered representatives to deal fairly with their customers and also requires that in making recommendations to a customer, the member must have reasonable grounds for believing that the recommendation is suitable for such customer and must make reasonable efforts to obtain information requiring the customer's financial status, tax status and investment objective. This suitability requirement is intended to prevent brokers from inducing their customers to purchase securities that are too risky for them.

Again, I think there's a parallel here that may be important in the gambling area. Consideration should be given to requiring gambling sponsors or entities attempting to persuade others to engage in gambling activities, to refrain from directing advertisements to potential gamblers who are unable to bear the financial risk of gambling losses.

There's a category of investing involving derivative instruments called options, a very complicated instrument. Here, when the risk is greater and the instruments are more complicated, the SEC and the options exchanges have more extensive disclosure requirements. The SEC requires options
disclosures and as a result the options exchanges have prepared a
disclosure document regarding risks of option holders and
writers, risks of index options, risks of debt options, risks of
foreign currency options, risks of flexibly structured options
and other risks such as combination options. This booklet which
is in Mr. Harris' exhibit called Characteristics and Risks of
Standardized Options is a 95-page pamphlet containing 31 pages
dealing with risks alone. It's intended to protect the investors
who are involved with this complicated area of investing.

As noted, gambling and investing share several common
elements. Both activities involve elements of risks that are not
within the control of the participants. Gambling and investment
products, by nature, require disclosure in order to be well
understood. Persons engaged in gambling and investing will have
varying degrees of financial sophistication and ability to bear
the risk.

In conclusion, I would like to repeat my
recommendations to you, which I may say are made by me in my
personal capacity and not as a member or former member of the
Securities and Exchange Commission, but they are heartfelt from
my point of view.

At a minimum, those conducting gambling activities
should be required to make adequate disclosures about the risks
of gambling. Disclosure should include a general warning about
the risks of gambling and specific disclosures of the odds
applicable to each form of gambling. Those conducting gambling
activities should be required to refrain from directing
advertisements to prospective gamblers who do not have the
financial sophistication necessary to understand the gambling risk and the financial ability to bear gambling losses.

We've seen hints of that with regard to tobacco advertising in this country and measures being considered in that industry. Third, although not a firm recommendation, I think consideration should be given to finding other ways to protect those who are either financially unsophisticated or unable to bear the risk of loss, such as by restricting access to gambling establishments or access to certain kinds of gambling. Thank you.

CHAIRMAN JAMES: Thank you.