

Gambling and Problem Gambling in the Financial Markets: Perceptions of Securities Attorneys

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Some investors who believe that stockbrokers and their firms mismanage their accounts (e.g., place their money in excessively risky investments) seek advice from attorneys who specialize in securities. Among these dissatisfied investors are compulsive gamblers who believe that brokers and their firms have taken unfair advantage of their proclivity toward speculation/gambling in the markets.

In order to obtain further information about the extent of gambling in the markets by investors and brokers, and the extent to which problem gambling may be present among investors who seek legal assistance relating to their grievances against brokers and brokerage firms, a survey was conducted of attorneys who specialize in securities.

METHOD

In the spring of 1997, the members of the Public Investors Arbitration Bar Association (PIABA) were mailed a survey on problem gambling in the markets (See Appendix). PIABA is the only national organization of attorneys which specializes in representing investors in arbitration actions against brokers and brokerage firms. The entire current membership (260) was mailed the survey and fifteen percent (36) returned the survey. Twelve percent (3) of the surveys returned were by women and approximately 8.5% of PIABA members were women.

In order to be certain those surveyed used the same criteria for problem gambling, the following major characteristics of problem gamblers were provided.

- Engages in speculative risk-taking resulting in significant losses in relation to level of assets.
- Chases losses through increasing speculation - difficulty stopping when losing. Investments highly leveraged.
- Borrows money in order to invest.
- The behavior appears erratic, inconsistent, irrational, and/or excessively frequent.

A problem gambler in the markets typically manifests most of the above characteristics. Additional signs may be noted in individual cases. The more of these characteristics a person manifests, the greater the likelihood she/he has a gambling problem.

RESULTS

The results are presented in accordance with the findings for each question in the survey.

Question 1 Thirty-three males and 3 females responded to the survey.

Question 2 All respondents were attorneys specializing in securities.

Question 3 The respondents were asked to indicate all of the areas in which problem gamblers are active from a list of twelve major ways of conducting investments in the markets. An additional "other" category was provided.

The frequencies and percentages for the 36 respondents selecting each area are provided below.

Excessive Use of Margin in Stocks, Options, Bonds & Treasury Securities	25 (69.4%)
Penny Stocks/Pink Sheet.....	24 (66.7%)
Stocks	24 (66.7%)
Futures Contracts	19 (52.8%)
Stock and Index Options.....	18(50.00%)
Initial Public Offerings (IPOs).....	14 (38.9%)
Short Selling of Stocks.....	12 (33.3%)
Limited Partnerships	2 (5.5%)
U.S. Treasury Securities	2 (5.5%)
Bonds.....	2 (5.5%)
Real Estate Speculation.....	1 (2.8%)
Foreign Currency Options.....	1 (2.8%)
Mutual Funds	0 (0%)

The respondents selected an average of 4.1 ways in which investors gamble in the markets. The range of categories selected by individual respondents was between 1 and 9 areas.

Question 4

The respondents were asked whether the level of risk in the more speculative areas of the markets is equal to the level of risk in casino gambling. Of the 30 (83%) respondents who provided an answer, the results were as follows:

The risk was equal - 11 (36.7%).

The risk was higher in the markets - 13 (43.4%).

The risk was higher in a casino - 6 (20%).

Comments by those who believe that risk is higher in the markets fall within the following categories:

- Due to leverage through margin and options and futures, market investments are riskier because a person can lose more than the amount invested or bet and, therefore, can be wiped out financially more quickly.

- Risk is higher in the speculative markets because individuals often don't know what they are investing in, while the bets can be seen in the casino.
- Unlike legitimate casinos, many times losses in the markets are predetermined and fixed. If the gambler in the casino discovers the game was fixed, he can get his money back but not in the more speculative areas of the market.
- Risk is greater in the markets because the cost of transactions make losses over time certain.

Of those who said that the risks in the markets and casino are equal, the points made focus on the similarity of odds, handicapping and addiction in both areas and the over-extension of margin in the markets.

Of those who believe that the risk is greater in casinos, only one respondent stated a reason: Gambling is based on lure and speculation, but investment on diligence, research, and known risk.

Question 5

The respondents were asked to indicate the total number of investors they have represented in claims against brokerage firms. Thirty-four (94%) of the respondents answered this question. Median = 87.5. Range = 10 to 5,500.

Question 6

The respondents were asked to indicate the number of investors they have represented in claims against brokerage firms who they believe were problem gamblers in any area of gambling. □ Thirty-four (94%) of the respondents answered this question. Median = 3. Range = 0 to 20.

Question 7

Twenty-six (72%) of the respondents answered this question. Respondents were asked the following questions relating to their problem gambling clients:

(a) "What is the number of investors you have represented in claims against brokerage firms who you believe were problem gamblers in the markets?" Median = 3 Range = 0 to 50

(b) "What is the number of these cases involving problem gamblers in the markets that were settled favorably for your client?" Median = 2 Range = 0 to 20

(c) "What is the number of these cases involving problem gamblers in the markets that were arbitrated favorably for your client?" Median = 1 Range = 0 to 15

"Do you believe that the fact that your client had a gambling problem contributed to the positive results in any of the settlements or arbitrations?" Yes: 3 (11.5%) No: 23 (88.5%)

Typical comments of the almost 9 of 10 (88.5%) who indicated that having a client who has a gambling problem did not contribute to positive results were as follows:

- I would want to settle.
- It's not good evidence.
- Cases were dismissed.
- Panel would not rule for a "gun-slinging" gambler.

- I lost an arbitration case because of compulsive gambling.
- Awards are down if client is compulsive gambler.
- If compulsive gambler, client assumes risk of loss.
- Brokerage industry assumes a voluntary trading pattern if client is a compulsive gambler.
- Gamblers behave erratically in the arbitration process.
- Gambler resents his attorney if he believes attorney is getting in the way of making a big hit.
- Did not know that two of my clients were compulsive gamblers until they had the same problem again.

Of the 3 (11.5%) respondents who believed that the gambling problem contributed to the settlement, 2 commented as follows:

- It was shown that the broker took advantage of the addicted gambler.
- The panel recognized the client was gambling.

Question 8

The respondents were asked to indicate how many times brokerage firms have acknowledged that their clients were gambling problematically in the markets. Twenty-nine (81%) of the respondents answered this question. Median = 1. Range = 0 to 7. The most frequent (5) comment was that brokerage firms claim the client was aware of the risk and chose the investment without encouragement by the broker. Other comments:

- Brokerage firms deny they knew the client was a compulsive gambler and deny any liability for failure to discover that the client was a compulsive gambler.
- Brokerage firms do not acknowledge compulsive gambling.
- Brokerage firms view a compulsive gambling defense as a cop-out.

Question 9

Respondents were asked to indicate the number of cases in which they represented investors in arbitration hearings where arbitrators acknowledged problem gambling in the markets as a legitimate issue. Twenty-seven (75%) of the respondents answered this question. Median = 0. Range = 0. Three comments were made by respondents:

- Arbitrators usually don't express what they are thinking.
- Arbitrators are generally skeptical and uneducated regarding addiction.
- A winning arbitration was due to a determination that the client was committing "financial suicide".

Question 10

Respondents were asked to indicate the number of times they had sought a consultation from an expert in problem gambling regarding the possibility that one of their clients had a gambling problem in the markets. Thirty-three (92%) of the respondents answered this question. Median = 0. Range = 0 to 7. The most common responses regarding why such consultation had not been sought were:

- Did not think it would help the case - very low likelihood of recovery.
- Did not think about using an expert in problem gambling.

Other single comments:

- Referred clients for counseling but they would not go.
- Referred client to counseling after losses.
- The expert would have shown that the client was directing the activity and not the stockbroker.
- Irrelevant to the issue.
- Few cases would need this consultation.
- Expense.
- None of my business.
- There is no dram shop liability and it would be very hard to prove.
- I may do this in a new case.

In the 7 (21%) instances where consultants were used, there were three comments:

- Used the consultant in the case where the customer was trading short term with equities on margin.
- No help in the one time a consultation was used.
- The one case I used a consultant is still pending.

Question 11

The respondents were asked to indicate the number of cases in which they strongly suspected or concluded that a stockbroker was aware that the client had a gambling problem. Thirty-one (86%) of the respondents answered this question. Median = 2. Range = 0 to 50. The respondents were asked whether they believed that the broker in these instances encouraged or discouraged the client(s) to continue gambling in their investments. Of the 23 respondents who commented, 21 (91%) indicated that when brokers were aware of their clients' gambling, they encouraged it, primarily in order for the brokers to earn greater commissions.

Question 12

Respondents were asked to specify the number of cases in which they believed their clients did not have a gambling problem and the broker encouraged the client to gamble or take excessive risks in their investments. Thirty-one (86%) of the respondents answered this question. Median = 2.5. Range = 0 to 50. The most common type of comment was that the brokers lied to their clients about the level of risk and that this was the basis for suitability and churning cases.

Question 13

The respondents were asked to indicate the number of cases in which they strongly suspected or concluded that their client's broker had a gambling problem. Of the 30 (83%) who responded to the question, 16 (53%) believed or suspected that the broker had a gambling problem. These respondents were asked whether they believed the problem was in the markets or in recreational forms of gambling. Ten (62.5%) of the 16 respondents indicated it was the markets and 6 (37.5%) indicated it was both the markets and recreational gambling.

There were 3 specific comments:

- The broker was gambling and losing in the markets and took the client down with him.
- In two cases, the brokers were drowning in debt and encouraged the client's risk taking.
- Most brokers gamble with their client's money and not their own.

Question 14

The respondents were asked whether they believed brokerage firm personnel should receive training and/or literature describing the potential for problem gambling among employees and a description of the signs of problem gambling in the workplace. Thirty-three (92%) of the respondents answered the question. Yes = 29 (87.9%). No = 4 (12.1%).

The following comments were volunteered:

- It would create an awareness of an existing problem.
- Knowing about the problem won't help the few honest ones with a problem.
- Use in the area of commodities trading.
- It is more important to closely review the broker's account.
- Most brokers have no money because they speculate and over trade their own accounts.
- The manager is already trained to detect and prevent this behavior.

Question 15

The respondents were asked whether they believe that brokerage firms should create a pamphlet describing the signs and symptoms of problem gambling in the markets which would be available to investors. Thirty-two (88.9%) of the respondents answered the question. Yes = 27 (84.4%). No = 4 (12.5%). Yes and No = 1 (3.1%).

The following comments were volunteered by those who said "yes":

- A good consumer protection step. It wouldn't hurt.
- It should reinforce the value of long term investment.
- It could create awareness and a duty of care toward investors.
- It should provide full disclosure of risks.
- Brokerage firms should acknowledge that market risk is like gambling.
- In commodities trading.
- It should describe psychological profiles and self-destructive behavior by clients.
- If they do so voluntarily.

The following comments were offered by those who said "no":

- Existing rules are sufficient.
- Good supervision is better than a pamphlet.
- Investors won't pay attention.
- It would give brokerage firms another defense.
- Brokerage firms wouldn't do it because gambling is pervasive, especially in today's markets.
- Brokerage firms would never do it because it would show they had a duty (which they deny) to stop a client from committing financial suicide.

Question 16

The respondents were asked whether they believe that brokerage firms should provide training and/or literature to brokers and other personnel describing the potential for problem gambling among investors. Thirty-one (86%) of the respondents answered the question. Yes = 27 (87.1%). No = 4 (12.9%).

Comments by those who said “yes”:

- A good consumer protection step especially for unsophisticated and uneducated speculators.
- It wouldn't hurt.
- In commodities trading.
- It creates an awareness and duty of care for clients.
- They are already supposed to do that.
- If they do so voluntarily.

Comments by those who said “no”:

- They should just follow existing rules.
- It's not that difficult to determine that a client's strategy or philosophy won't work.
- Brokerage firms never will because gambling fever is pervasive, especially in today's markets.
- It's not their responsibility.

Question 17

Respondents were asked whether they believe that brokerage firms should provide some funds to support education, research and treatment programs for problem gamblers in the markets. Twenty-nine (80.6%) of the respondents answered the question. Yes = 13 (44.8%). No = 16 (55.2%).

Comments included:

- Not the brokerage firms' responsibilities, but good public relations.
- For education and research but not treatment.
- Only if it's voluntary.

Question 18

Respondents were asked to indicate how the policies and practices of brokerage firms impact problem gambling. Thirty (83%) of respondents answered this question. Responses fell within the following categories:

- Encourage problem gambling: 21 (67.7%)
- Discourage problem gambling: 1 (3.2%)
- Both encourage and discourage problem gambling: 4 (12.9%)
- Neither encourage nor discourage problem gambling: 5 (16.1%)

Question 19

Respondents were asked whether there are policies and practices that they believe brokerage firms should adopt in order to discourage or limit problem gambling in the markets. Thirty-one (86%) of the respondents answered this question. Yes = 22 (71%). No = 9 (29%).

Comments:

- Paying brokers on a transaction basis encourages recommending excessive transactions.
- Brokers pay should be based on results.
- Brokers pay should be based on assets under management.

- Penny stock houses and unscrupulous brokers encourage trading at any cost.
 - Carefully monitor broker's own trading.
 - Stop the churning.
 - Need more compliance oversight.
 - Monitor accounts closely.
 - Monitor heavily traded accounts.
 - Develop procedure to notify clients if losses or trading is excessive.
 - Policies to monitor excess activities seldom enforced.
 - Someone other than the broker should warn the clients if there is a problem with the account.
 - Limit positions.
 - Assign clients who are suspected problem gamblers to specially trained brokers who can act as a fiduciary.
 - Brokerage firms should close the accounts of problem gamblers if a client disregards the firm's advice.
 - Act as fiduciary. There should be no caveat emptor for most accounts.
 - Identify problem gambling and stop it.
 - Develop a policy to ask every investor if they have ever had a gambling problem, record response and have client initial response.
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- Brokerage firms have no policy or concern about problem gambling.
 - To concede the existence of problem gambling is too dangerous to revenue.
 - Reputable firms have supervisory policies to stop excessive and speculative trading.
 - It is practically difficult to deal with problem gambling.
 - Need policy to refuse unsuitable trade. To earn commissions, the suitability rule is ignored.
 - Create a pamphlet.
 - Train brokers.
 - Need supervisors to do their job.

Question 20

Respondents were asked whether they would like to make recommendations to the Securities and Exchange Commission (SEC) regarding the actions the SEC could take to deal with problem gambling in the markets. Thirty-two (88.9%) of the respondents answered this question. Yes = 17 (53%). No = 15 (47%).

The following recommendations were offered:

- SEC and NASD don't regulate the markets.
- SEC doesn't enforce the rules.
- SEC should enforce supervisory rules.
- SEC should require and enforce rules to refuse unsuitable trades.
- SEC should develop stricter guidelines regarding excessive trading.
- SEC should study the issue of problem gambling.
- SEC should develop a rule to prohibit trading by suspected problem gamblers.
- SEC should discipline problem gamblers.
- SEC should require monitoring accounts for problem gambling.
- SEC should require problem gambling recognition training.
- SEC should require distribution of a pamphlet or other information on problem gambling.

- SEC should require that a spouse should be JRO'd on accounts and child/relatives receive duplicate confirmation statements.
- Impossible to regulate problem gambling behavior and SEC shouldn't try.
- It goes beyond SEC's mandate.

DISCUSSION

Areas of the Markets in Which Investors Gamble

It is clear from the results that 7 out of the 13 areas of investment were frequently (between 33% and 69%) perceived by these securities attorneys as areas of gambling. A median of 4 different areas of gambling was selected by the attorneys. These results indicate that vehicles for gambling in the markets are readily available for investors.

In 1994, Steinberg and Harris utilized a similar instrument with a sample of stockbrokers to learn more about problem gambling in the markets. The results for the stockbrokers were similar to the attorneys in that 6 out of 12 areas of investment were frequently (between 40% and 65%) perceived as areas of gambling.

Casino vs. Market Risk

Eighty percent of the securities attorneys perceived the level of risk in the more speculative areas of the markets to be equal to or greater than the risk in the casino. In the stockbroker study, 59% of the brokers had the same perception.

Percent of Investors with a Gambling Problem

The results indicate that the securities attorneys as a group had represented a relatively large number of clients in arbitrations (median number equals 87.5 clients), with a small number (median equals 3) of these clients (3.4%) perceived to be problem gamblers. While the 3.4% is the roughest of estimates, it should be noted that Shaffer and associates (1998) found in a review of prevalence studies in the field of problem gambling that about 1.6% of the adult population in the United States has a severe gambling problem and another 3.8% a mild to moderate problem.

Arbitration Not Successful for Investor Problem Gamblers

The attorneys believed (88.5%) that when their clients had a gambling problem there was less likelihood of success in arbitration due primarily to the perception by brokerage firms and arbitrators that the client's gambling was voluntary. With little expectation of positive benefit, it follows that only 21% of the attorneys had ever sought a consultation from an expert in problem gambling when they believed their clients had a gambling problem in the markets and it is not surprising that the median number of consultations was zero.

Brokerage Encouragement and Discouragement of Problem Gambling

The attorneys had been involved in a median number of 2 arbitration cases (2.3% of total number) in which they suspected or concluded that the stockbroker was aware that the client had a gambling problem. However, ninety-one percent (21 out of 23) of the attorneys who commented on whether brokers encouraged or discouraged their client's problem gambling believed that when the brokers were aware of the problem gambling, they encouraged it. Similarly, when the attorneys were asked whether the policies and practices of brokerage firms encourage or discourage problem gambling in the markets, 68% stated their belief that brokerage firms encourage problem gambling, and only 3% believe firms discourage problem gambling. In the earlier study of stockbrokers, these results were somewhat reversed in that 49% of the brokers believed firms discouraged problem gambling and 12% believed that firms encouraged it. Do attorneys overestimate the problem in adversarial arbitrations or do brokers underestimate the problem in defense of themselves and their firms?

Broker Problem Gambling

There was a median of 2 (2.3%) cases in which the attorneys suspected or concluded that brokers themselves had a gambling problem (primarily in the markets). This conclusion is based on substantially less information than the conclusion that the attorneys' clients had a gambling problem. In the stockbroker study, brokers indicated that approximately 10% of brokers in general have a gambling problem in the markets and 10% of the brokers in the sample stated they had a gambling problem themselves.

Educating Investors and Brokers about Problem Gambling

There was strong support for steps by brokerage firms to increase the awareness of investors about the possibility of problem gambling among investors (84%) and to increase awareness of brokers about problem gambling among investors (87%) and problem gambling among brokerage firm employees (88%). There was considerably less support (45%) for brokerage firms providing some funding for problem gambling education, research and treatment programs. However, it is important to note that almost half the attorneys believe brokerage firms should have a high degree of responsibility for alleviating problem gambling through funding. In the stockbroker study, only 30% of brokers agreed with the idea of brokerage firms making available a pamphlet about problem gambling to investors and 17% agreed that brokerage firms had a responsibility to provide funding for problem gambling services.

Changes Needed in Brokerage Industry Policies and Practices

Seventy-one percent of the sample of attorneys (as compared with 36.5% of brokers in the earlier study) indicated a need for changes in policies and practices in brokerage firms and offered suggestions for changes to discourage or limit problem gambling in the markets. In addition, 53% of securities attorneys offered recommendations to the Securities and Exchange Commission for taking actions related to problem gambling.

SUMMARY AND CONCLUSIONS

While no specific biases in the sample were noted, it is not known whether the attorneys sampled are representative of all the members of PIABA. This is due to the facts that there is insufficient information to compare the demographics of the sample with the demographics of the PIABA membership as a whole and that only 15% of the surveys were returned. Therefore, conclusions should be considered tentative.

1. Securities attorneys perceive that investors gamble, not only in the speculative areas of the markets but also in traditional investment vehicles.
2. The level of risk in the more speculative areas of the markets is perceived as equal to or greater than the risk in casino gambling.
3. A small proportion of investors who enter into arbitrations with brokerage firms are perceived as problem gamblers. Arbitrations in these cases are less likely to be successful largely due to the perception of brokerage firms and arbitrators that all gambling is volitional.
4. The attorneys perceive brokers and brokerage firms as encouraging problem gambling and doing extremely little to discourage it.
5. The majority of attorneys indicated the need for introducing policies and practices within the brokerage industry and by the SEC to deal with problem gambling.

6. The attorneys strongly endorsed the recommendation that investors receive literature and brokers receive education and training about problem gambling in the markets. The author is not aware of any literature available through a brokerage firm which attempts to increase awareness or expresses concern about the issue of problem gambling. Industry and government regulatory bodies have also been silent on this issue, with one recent exception. In June, 1998, after extensive review of the author's pamphlet, "Investing and Gambling Problems", the SEC's Office of Investor Education and Assistance began providing the pamphlet to investors who request it.
7. In comparison with the previous survey with stockbrokers, the following similarities and differences in perceptions between brokers and securities attorneys were identified:

Similarities: The financial markets provide a large number of vehicles in which investors gamble; the more speculative areas of the markets are equal to or greater in risk than a casino.

Differences: Attorneys considerably more than brokers believe that brokers and brokerage firms encourage problem gambling (68% vs. 12%), while fewer attorneys than brokers believe that brokers and brokerage firms discourage problem gambling (3% vs. 49%); attorneys far more than brokers favored investor education about problem gambling (84% vs. 30%) as well as funding by brokerage firms of problem gambling services (45% vs. 17%).

Problem gambling in the financial markets is the least studied major area of gambling by social scientists. Further, problem gamblers in the markets rarely receive treatment for this problem by mental health and addictions professionals (Harris and Steinberg, 1994). This lack of recognition and attention is understandable given the fact that it took Gamblers Anonymous 29 years (from its founding in 1957 until 1986) to include stock market investment and trading as a form of gambling which should not be engaged in by recovering gamblers (Gamblers Anonymous Combo Book, 1996). Further, utilizing the casino industry as an example, it was not until 1997 that a widespread attempt was undertaken to address problem gambling (American Gaming Association, 1997).

It is likely that as research in problem gambling in the markets develops further and an increasing number of investor problem gamblers are treated, the brokerage industry will probably acknowledge the problem and will provide information to customers and employees about the signs and symptoms of problem gambling and where help is available.

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