

CFTC LETTER NO. 23-03 OTHER WRITTEN COMMUNICATIONS MARCH 2, 2023



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of
Market Oversight

CFTC Letter No. 23-03
Other Written Communication
March 2, 2023
Division of Market Oversight

Professor Margaret Hyland, Ph.D.
Vice-Provost (Research)
Vice Chancellor's Office
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**Re: Withdrawal of CFTC Letter No. 22-08 And Initial Determination
Concerning CFTC Letter No. 14-130**

Dear Dr. Hyland:

This letter hereby withdraws and supersedes the undersigned's correspondence of August 4, 2022.¹

As Victoria University of Wellington, New Zealand ("Victoria University" or "the University") is aware, on October 29, 2014, the Division of Market Oversight ("DMO" or "Division") of the Commodity Futures Trading Commission ("CFTC" or "Commission") issued CFTC Letter No. 14-130 ("Letter 14-130" or "the Letter") granting the University's request that the Division not recommend enforcement action (*i.e.*, the Division's "no-action" position) against the University in connection with its operation of an online, not-for-profit, event contract market in the U.S. for educational and research purposes, without registration as a designated contract market, swap execution facility, or foreign board of trade, and without registration of its operators, subject to

¹ CFTC Letter No. 22-08.

certain terms outlined in the Letter.² We refer herein to the market platform established after Letter 14-130 was issued as “the Market” or “the Platform.”

According to the terms of the Letter, which DMO issued based upon the representations of the University, the proposed event contract market would:

- (1) be small-scale and not-for-profit;
- (2) be operated for academic and research purposes only;
- (3) be overseen by faculty at the University, without receipt of separate compensation, directly or indirectly, for operating the market;
- (4) offer event contracts consisting of two submarkets for binary option contracts concerning political election outcomes and economic indicators;
- (5) be limited to 5,000 traders per contract, with an \$850 investment limit per participant in any contract;
- (6) not offer brokerage services or charge commissions to participants;
- (7) utilize a third-party service provider to perform know-your-customer (“KYC”) due diligence on its participants;³
- (8) only charge those fees necessary to cover the fulfilment of the KYC process, regulatory compliance, and basic expenses to operate the proposed event contract market; and
- (9) limit advertising to media outlets where there is a high likelihood of reaching those interested in the subject matter of its event contracts, provided that such advertising prominently discloses that the platform is unregulated, experimental, and being operated for academic purposes.⁴

Victoria University proposed the creation of a small-scale, not-for-profit, online market for event contracts in the U.S. for educational purposes modelled after the non-profit election market operated by the University of Iowa. The Iowa Electronic Market is operated for academic purposes only, and its operators, who are faculty at the University of Iowa, receive no separate compensation. As such, Letter 14-130 states that DMO’s no-action position was “[b]ased upon” Victoria University’s “representations concerning the purposes and manner of operation of [the University’s] proposed market for event contracts,” “and is subject to the conditions stated above.”⁵ The Letter was addressed solely to Victoria University and addressed solely “Victoria

² CFTC Letter 14-130.

³ *Id.* at 3.

⁴ *Id.*

⁵ *Id.* at 5.

University’s market for event contracts, as proposed,” whose proposed operators were to be three professors at the University and one administrator who would not receive “payment, directly or indirectly, for operating the market.”⁶ The Letter noted that the University would utilize a third party, Aristotle International, Inc. (“Aristotle”), a for-profit corporation, to “implement an age and identity verification system as part of a KYC process.”⁷ The Letter expressly cautioned that any “different, changed or omitted material facts or circumstances” might result in DMO’s discretionary no-action position being “void” or withdrawn.

On June 8, 2022, DMO staff met solely with representatives of the University, including the University’s counsel, to communicate that the Platform was not being operated pursuant to the conditions set forth in Letter 14-130 and that the Division intended to promptly issue a public notice of withdrawal. At that time, DMO staff raised the following three bases for withdrawal:

- The Platform was no longer operated by the University or its professors, but rather by Aristotle;
- Victoria Link Limited (“VLL”), a wholly owned subsidiary of the University, has been receiving compensation from Aristotle; and
- The Platform had listed contracts outside the scope of Letter 14-130.

Following a series of subsequent phone calls and emails between DMO staff and the University (as well as, at the University’s invitation, Aristotle),⁸ in a letter dated August 4, 2022 (Letter 22-08), DMO notified the University that Letter 14-130 was being withdrawn because “[t]he University has not operated its market in compliance with the terms of Letter 14-130.”

By this letter, Letter 22-08 is withdrawn. DMO nevertheless preliminarily believes Letter 14-130 is void and should be withdrawn. The bases for this Initial Determination are set forth below, including those previously explained to the University, along with further information disclosed since August 4, 2022, which also informs staff’s analysis of this Initial Determination.

Aristotle, a for-profit corporation—not the University or its faculty—is operating the Market.

As noted above, Letter 14-130 was conditioned on the University’s representation that the proposed market would be operated and overseen by faculty at the University, without receipt of separate compensation, for academic and research purposes only. Inconsistent with the University’s representations made when requesting DMO’s no-action position in 2014, in a letter

⁶ *Id.* at 1–2.

⁷ *Id.* at 3 n.4.

⁸ The University obtained U.S. counsel and invited Aristotle representatives, including in-house and outside counsel.

from VLL Chief Executive Officer Anne Barnett dated April 20, 2021, the University notified DMO that the University was not operating the Market as of that time. According to the University's letter, "Aristotle's role now includes" the following: market question formulation; publicity; regulatory compliance; clearing and settling of contracts; market security, monitoring, and complaint and dispute resolution; provision of the Market website and the trading platform software that underlies this (including operation and maintenance of the website and software); and responding to requests from academics for data.⁹ This activity goes beyond the KYC due diligence and age verification on market participants that the University represented the so-called third party would conduct and is inconsistent with the terms of the Letter. As explained to the University before DMO issued the August 4, 2022 letter, this is one basis upon which DMO believes it should exercise its discretion to withdraw the Letter.

While the University may have been operating the Market at its inception, it appears that at some point the University ceded operational control of the Market to Aristotle, a for-profit corporation. Indeed, recent public statements reflect that the University may not have been operating the Market since its inception and rather that Aristotle played a leading—and undisclosed—role in the development and launch of the Market. Specifically, in declarations submitted under penalty of perjury, Aristotle and its executives have characterized Aristotle and its subsidiaries as "partners" with Victoria University, whose role is to "operate the Market" and who had "invested millions to set up" the Market's "computer systems and compliance infrastructure" and "to hire and train the staff to run them."¹⁰ And in a February 8, 2023 oral argument before the United States Court of Appeals for the Fifth Circuit, Aristotle's counsel made several representations indicating that the Market was a joint venture from the beginning. The Letter required the Market to be operated by Victoria University; the operation of the Market by Aristotle, a for-profit corporation, is inconsistent with the conditions in the Letter.

The University has received, and permitted Aristotle to receive, separate compensation for Aristotle's operation of the Market.

As noted above, Letter 14-130 was conditioned on the representation of the University that the market would be operated and overseen by faculty at the University, without receipt of separate compensation. The University letter to DMO dated April 20, 2021 states that the VLL, a wholly owned subsidiary of the University, receives \$2,000 each month from user fees "to fund its monitoring activity." As explained to the University before DMO issued the August 4, 2022

⁹ 4.20.2021 Letter at 3.

¹⁰ See, e.g., Corrected Plaintiffs-Appellants' Br., *Clarke v. CFTC*, No. 22-51124, at 7, 10, 36 (5th Cir. Jan. 31, 2023); Dec. 31, 2022 Decl. of John Phillips, *Clarke v. CFTC*, No. 22-51124, at Ex. 1 (5th Cir. Jan. 12, 2023) (sworn statement from Chief Executive Officer of Aristotle International, Inc. disclosing detailed trading-volume and related operational data); Sept. 28, 2022 Decl. of Dean Phillips, *Clarke v. CFTC*, No. 22-51124, at App.3-8 ¶¶ 4, 5 (5th Cir. Jan. 12, 2023) (sworn statement from President and Co-Founder disclosing that Aristotle International, Inc. "assisted" the University's 2014 request for no-action letter and "shepherd[ed] it through the CFTC's regulatory process"; that "Aristotle invested over seven million dollars to stand up the [Platform]"; and that Aristotle was responsible for "develop[ing] a software backbone and internet interface for the Market," and having "hired, trained, and maintain[ed] an employee base of seven fully dedicated (full time) employees and 18 employees who split time between [the Platform] and other Aristotle businesses").

letter, this appears to constitute separate compensation received by the University and thus is in violation of the terms of Letter 14-130.

Separately, Aristotle's assertions about its operational control, as referenced above, have drawn into question whether Victoria University also acted in a manner inconsistent with the representations that the University would create a small-scale, not-for-profit, online market. In particular, the market was designed to bear many close similarities to the University of Iowa model, including "no additional fees other than those necessary to cover basic expenses of running the market, including the cost of credit card processing of deposits and withdrawals, fulfillment of the know-your-customer ("KYC") process, and all other associated regulatory and compliance costs."¹¹ However, statements on the Platform's website indicate that Aristotle was charging a 10% fee on all profits and a separate 5% fee on all withdrawals for so called "costs related to running this site."¹² This fee structure appears likely to generate funds far greater than those necessary to operate a small-scale market. As such, it appears facially inconsistent with the University's representation that it would conduct a small-scale, non-profit operation, covering only basic expenses, in a manner similar to the Iowa Electronic Market.

The University has offered numerous contracts that are outside the scope of the submarkets addressed in the Letter.

As stated in the Letter, the University represented to DMO that it would operate two submarkets: one for political event contracts and the other for economic indicator contracts. The submarket for political event contracts would include contracts predicting the following outcomes:

- Which presidential nominee will win his or her party's primary, the general election popular vote, and the Electoral College;
- Who will be the major party nominees for Vice President; and
- Which party will control the next Congress.

The submarket for economic indicator contracts would include contracts predicting monetary policy decisions of the Federal Open Market Committee regarding the federal funds target rate.¹³

But, as previously explained to the University before DMO issued the August 4, 2022 letter, the Market has repeatedly listed a significant number of contracts that fall outside of the bounds of these two submarkets as represented to DMO and described in the Letter. More specifically, starting in 2014, not long after the issuance of the Letter, the Market began listing contracts that cannot reasonably be construed as falling within the categories of political event contracts set

¹¹ CFTC Letter 14-130.

¹² See "Our Fees" available at <https://www.predictit.org/support/how-to-trade-on-predictit>.

¹³ CFTC Letter 14-130. The University further represented that it would not list any economic indicator contract that would compete with any contract that is listed by a CFTC-regulated contract market, and the University would not list more than five economic indicator contracts at any one time. Participation in the submarket for economic indicator contracts would be limited to students, faculty and staff at any participating universities.

forth in the Letter or as akin to those contracts.¹⁴ Contracts that the Market has listed that are outside of the bounds of the Letter include the following:

- How many Ebola cases in the U.S. in 2015?
- Will Iran agree to a nuclear deal before the end of 2014?
- Will Caitlyn Jenner address the 2016 Republican National Convention?
- Will Puerto Rico file for bankruptcy in 2015?
- Will accused lion poacher Walter Palmer be extradited to Zimbabwe this year?
- Who will win the 2015 Nobel Peace Prize?
- Will North Korea test a hydrogen bomb by the end of 2016?
- Will September CBP Southwest Border Patrol apprehensions be lower than August?
- Will Pope Francis vacate the papacy by year-end?
- How many tweets will @realDonaldTrump post from noon May 27-June 3?
- Will federal charge against Andrew McCabe be confirmed by June 30?
- Whether the WHO will declare COVID-19 to be a “pandemic” before March 6?
- How many tweets will @AOC post from noon March 9 through March 16?
- What will be NASA’s estimate for global surface temperature change for February?
- Will the Court legalize same-sex marriage?
- Will the U.S. indict FIFA president Sepp Blatter in 2015?
- Will a federal charge against Hunter Biden be confirmed by December 31, 2020?

Despite multiple interactions with DMO to address these violations of the Letter’s conditions, the Market has persisted for years to list contracts outside of the two submarkets.

* * *

The purpose of Victoria University’s request and DMO’s no-action letter was that the Market—which the University represented would be a small-scale, not-for-profit platform for educational and research purposes—would be unregulated. Yet, because of these violations, DMO and other CFTC staff have been required to devote considerable time over the last nearly nine years to the Market. This has far exceeded the level of CFTC staff involvement contemplated by Letter 14-130, and we believe it is not an appropriate use of taxpayer resources. Further, the Market’s listing of contracts well outside of the scope of Letter 14-130 creates the false impression that DMO staff has determined that these contracts are acceptable. These are additional factors that incline us to exercise our retained discretion to withdraw the Letter. As a result of the University’s non-compliance with the terms of Letter 14-130, DMO has determined as a preliminary matter that Letter 14-130 is void and should be withdrawn.

¹⁴ For avoidance of doubt, these contracts also were not based on economic indicators as discussed in the Letter.

On a number of occasions, Victoria University and Aristotle have requested that the Division's no-action position continue to apply to certain markets until they expire on their own terms, after the 2024 elections. Victoria University and Aristotle have further requested that the no-action position be extended in the meantime to new markets, and to higher position limits than are covered under the Letter. Preliminarily, DMO does not believe this would be appropriate given the University's persistent violations of the conditions of the Letter, which at a minimum, suggest the likelihood of recurrence. This would therefore cause additional unreasonable use of taxpayer resources for the Division to verify that the University has begun to comply with the Letter's conditions, and continue to do so over the next nearly two years. To the extent the University believes that withdrawal of the Letter would cause downstream injury to third parties, we believe the better course would be for the University, Aristotle, or others to remedy them, if at all, by compensating any injured parties directly.

To the extent that the University disagrees with these conclusions, DMO exercises its discretion to invite the University to submit any objections it may have. Please send the University's response, if any, by March 20, 2023.¹⁵

This letter, and the positions taken herein, represent the views of DMO only, and do not necessarily represent the position or view of the Commission or any other office or division of the Commission.

Sincerely,

Vincent McGonagle

Vincent McGonagle

Director

Division of Market Oversight

¹⁵ We reiterate, consistent with our previous statements, that a response, if any, should come from the University and its counsel alone.