

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA**

KALSHIEX LLC,

Plaintiff,

v.

COMMODITY FUTURES TRADING
COMMISSION,

Defendant.

No. 23-cv-03257-JMC

Joint Appendix under Rule 7(n)
Volume 4

**JOINT APPENDIX UNDER RULE 7(n)
VOLUME 4**

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July 23, 2023

SUBMITTED VIA CFTC PORTAL
Secretary of the Commission
Office of the Secretariat
U.S. Commodity Futures Trading Commission
Three Lafayette Centre 1155 21st Street, N.W.
Washington, D.C. 20581

Re: Comments Responding to the Commission's Specific Questions Related to KalshiEX, LLC's Proposed Congressional Control Contracts

To Whom It May Concern:

KalshiEX, LLC ("Kalshi" or "Exchange") is grateful to the Commission for its consideration of Kalshi's proposed contracts. As with Kalshi's previous submission, the Exchange welcomes the opportunity to address the Commission's questions in full. Public comment is a critical tool for the Commission to engage with market participants and gauge the public's stance on issues regarding contract utility, surveillance, and viability.

The Commission is unique among financial regulators for its commitments to, and success fostering, innovative new products. As Chairman Behnam testified recently in front of the Senate Agriculture Committee,

On September 21, 1922, nearly 100 years ago to the day, the Grain Futures Act of 1922 was signed into law, which led to the near immediate establishment of the then CFTC. With that legislative accomplishment, this Committee and the Congress swiftly responded to a policy need that arose on the heels of emerging risks to American consumers because of new financial markets and products, technological innovation, and the promise of economic development. With the CFTC's rich history overseeing commodity markets, coupled with its expertise and track record, which rests on a firm foundation as a forceful and disciplined cop on the beat, the Agency stands ready to tackle these new risks and opportunities one century later.¹

Or as former Chairman Giancarlo wrote to the same body,

...the CFTC has been at the forefront of US financial market innovation since the agency's inception. In fact, the CFTC was reformulated over forty years ago into an

¹ Testimony of Chairman Rostin Behnam Regarding the Legislative Hearing to Review S.4760, the Digital Commodities Consumer Protection Act at the U.S. Senate Committee on Agriculture, Nutrition, and Forestry. September 15, 2022. Available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam26>.

independent body specifically to safeguard a breakthrough in financial innovation – financial futures – that enabled the global economy to hedge the risk of moving interest and exchange rates ensuring the US Dollar’s primacy as the world’s reserve currency. During the past decades, the CFTC has deftly overseen more new financial product innovation than almost any other market regulator.²

Projects like LabCFTC—now the Office of Technology Innovation—, and the continued efforts by the Commission to regulate digital asset markets, remind us of the agency’s commitment to responsible innovation. Responsible innovation is in the public interest and provides market participants with hedging and price basing opportunities they would not otherwise have.

Kalshi’s contract is yet another iteration of this endeavor. The contract is compliant with the law, Core Principles, rules, and regulations. It has broad hedging and price-basing utility and social value, as detailed by Kalshi’s submission to the Commission and dozens of public comments from retail customers, small businesses, and leading members of industry. The Commission’s decision should consider the full weight of evidence that it has been provided with, beginning with Kalshi’s original submission regarding political control contracts to DMO on March 28, 2022, until today. That evidence comes from academic research, market testimony, and other election markets running in the United States and abroad. After considering all of this evidence, there is only one reasonable determination the Commission can make: that these contracts comply with the Commodity Exchange Act (“CEA”) and are affirmatively advance, as the CEA’s mission reminds us, the “national public interest by providing a means for managing and assuming price risks, discovering prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities.”

In these responses, the Exchange references and integrates comments from the prior submission, as well as the current one, which Kalshi strongly believes are material to this matter.

1. Do these contracts involve, relate to, or reference gaming as described in Commission regulation 40.11(a)(1) and section 5c(c)(5)(C) of the Commodity Exchange Act, or in the alternative, involve, relate to, or reference an activity that is similar to gaming as described in Commission regulation 40.11(a)(2) and section 5c(c)(5)(C) of the Commodity Exchange Act?

The application of the Special Rule in section 5c(c)(5)(C) of the Commodity Exchange Act (“Special Rule”) is addressed at length in its original submission, including letters provided by our counsel Elie Mishory, along with former CFTC General Counsel Jonathan Marcus and

² Giancarlo, J. Christopher. “J. Christopher Giancarlo Letter in Support of the Digital Commodities Consumer Protection Act.” September 15, 2022. Available at <https://tabbforum.com/opinions/j-christopher-giancarlo-letter-in-support-of-the-digital-commodities-consumer-protection-act/>.

former CFTC General Counsel Dan Davis.³ Additional commenters on this point include former Nadex CEO Timothy McDermott, as well as other public comments by former CFTC officials and industry actors such former Commissioner Brian Quintenz, former Commissioner Mark Wetjen, “father of futures” Dr. Richard Sandor, Gregory Kuserk, who led the Product Review branch in DMO, former MPD Director Josh Sterling, Daniel Gorfine, Lewis Cohen, Jeremy Weinstein, Susquehanna International Group, Tabet DiVito & Rothstein, and Railbird Technologies.⁴ Many other comments also detail the qualitative differences between the contracts proposed by Kalshi and gaming, by virtue of the contract’s economic purpose. The Exchange makes the following points as well.

1: Elections and political control are not games.

Unlike games, in which the underlying activity has no inherent economic value apart from the money wagered on it, political control has an obvious and large economic impact, as it heavily influences expectations and the likelihood of public policy change. As Gregory Kuserk noted, unlike games, “Elections are events that are very important to the public, and there is a very strong public interest in having accurate data regarding elections.”⁵ Kalshi detailed as much in dozens of pages of evidence provided to the Commission, drawing on private and university research, policymaker and industry testimony, and the financial press.⁶ Many public comments by retail, industry, and academia have confirmed as much.⁷

Kalshi’s contracts do not involve gaming. It involves the partisan affiliation of the Speaker of the U.S. House of Representatives and the U.S. Senate’s President *pro tempore*, which are not determined through or relate to games of chance, or games of skill.⁸ Elections are not games, full stop. Indeed, the *Nadex Order* did not identify political elections themselves—the core of American democracy—as being a game.⁹

³ Public comment by Elie Mishory. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70781>.

⁴ Public comments 70786, 70771, 69687, 70754, 69737, 70755, 69736, 69723, 70743, 70765, 70752.

⁵ Public comment by Gregory Kuserk. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70754>.

⁶ Memorandum in Support of Kalshi’s Political Control Contracts, submitted to Division of Market Oversight (DMO) March 28, 2022.

⁷ See public comments by Chicago Booth school Professor Michael Gibbs and Susquehanna International Group Special Counsel David Pollard. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69704> and <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70743>.

⁸ Kalshi’s Congressional control submission, available at: <https://www.cftc.gov/sites/default/files/filings/ptc/22/08/ptc082422kexdc001.pdf>. See page 9.

⁹ In the Matter of the Self-Certification by North American Derivatives Exchange, Inc. of Political Event Derivatives Contracts and Related Rule Amendments under Part 40 of the Regulations of the Commodity Futures Trading Commission (April 2, 2012), available at: <https://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>.

2: Trading on Congressional control is not gaming

The *Nadex Order* asserted that gaming is equivalent to placing a wager or bet, and it cited a federal statute that defined the term bet or wager as “the staking or risking by any person of something of value upon the outcome of a contest of others.”¹⁰ If taking a position on a Congressional control contract is equivalent to a ‘wager’ or ‘bet’ because it places money on an event’s outcome, that would imply that taking a position in any event contract is also equivalent to a ‘wager’ or ‘bet’.¹¹ This is not true in law. While gambling is illegal in many states and interstate betting is prohibited, event contracts are legal in all jurisdictions. As former Commissioner Quintenz wrote:

Gaming describes wagering money on an occurrence that has no inherent economic value itself other than the money wagered on its outcome. For instance, wagering money on roulette or blackjack should be considered gaming because there is no economic significance of the activity apart from the wager itself. Speculation, on the contrary, is risking value where the underlying activity has economic consequences, which then means the speculative activity creates valuable societal and economic benefit from a price-discovery and risk transfer function for those exposed to the risk of that underlying activity..¹²

The relevant language of “involve, relate to, or reference” comes from Commission regulation 40.11.¹³ This language cannot be broader than the statutory language that is simply “involves”.¹⁴ By definition, if the regulation applied *more broadly* than the statute, it would per se violate the APA and be invalid.¹⁵

2. What role does the requirement that the contracts trade in multiples of 5000 and/or the position limits applicable to the contracts play in the analysis of whether the contracts involve, relate to, or reference gaming as described in Commission regulation 40.11(a)(1) and section 5c(c)(5)(C) of the Commodity Exchange Act? Are the position limits reasonably enforceable?

It does not play a role. A larger order size will likely reduce the number of smaller traders and trades, but does not affect the contract’s hedging utility.

¹⁰ *Nadex Order* at 3

¹¹ Some commentators appear to equate speculation with gaming and do not sympathize with the important role speculation plays in price discovery and risk transfer. Many commodity futures markets, such as those in oil, often feature large amounts of speculative behavior yet clearly do not constitute “gaming” contracts.

¹² See Public Comment on Kalshi Contracts from Brian D. Quintenz, available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70786>

¹³ 17 C.F.R. § 40.11(a)

¹⁴ 7 U.S.C § 7a-2(c)(5)(C)

¹⁵ Quintenz, *ErisX*.

The position limits are enforceable; Kalshi is regulated by the Commission who can monitor such behavior. Other exchanges list products with custom order sizes, notional sizes, and position limits as well. There is no reason to speculate that Kalshi will somehow not be able to enforce this. Indeed, the Division is well aware of Kalshi's ability to enforce position limits. Additionally, it is not clear why Kalshi's ability to enforce a rule is appropriate for public comment. How is a member of the public supposed to have information on Kalshi's systems and procedures and internal processes for compliance? It would seem that the most appropriate party to address this question to is Kalshi, and Kalshi notes that surprisingly and incongruously, the Commission has never asked Kalshi this question.

3. Should the Commission consider whether similar offerings are available in traditional gaming venues such as casinos or sports books and/or whether taking a position on elections or congressional control is defined as gaming under state or federal law?

1: Should the Commission consider whether similar offerings are available in traditional gaming venues such as casinos or sports books?

No, the Commission should not consider this in determining whether a contract is gaming and subject to the Special Rule for event contracts, for four reasons:

1. Presence on an illegal exchange, casino or sportsbook does not by right cause relation to gaming. For example, if corn futures become widely traded in casinos and sports books, that would not change the nature of the corn futures contract into a gaming contract. The converse is also true. If a traditional futures exchange started a roulette parlor, the bets in the parlor would still be gaming.
2. What is offered at such venues changes over time. For example, if we used this "nature of the venue determines nature of the product" standard, many commodity futures and securities might have originally been considered gaming because bucket shops traded those products in large volumes in the late 19th and early 20th centuries. They may have continued to do so in the absence of bucket shop prohibitions.
3. The Commission prevented Congressional control contracts from being listed on-exchange in the *Nadex Order*. It would be circular to use the fact that such activity has persisted off-exchange as evidence the activity is gaming. For example, if the Commission prohibited oil futures, and oil futures trading moved to casinos, that would not suddenly change the economic nature of oil futures.
4. The Commission did not consider the venues offering, for example, Bitcoin contracts prior to the listing of Bitcoin contracts on DCMs. If the Commission considered this inquiry to be dispositive that something is gaming, those contracts would be gaming contracts because of their large presence on such venues.

However, even if the Commission did consider venue as relevant in determining whether the contracts involve gaming, Congressional control is not offered on any legal American sportsbook and is not available in casinos, like those in Las Vegas.¹⁶ Bets on the control of Congress aren't accepted at Caesar's Palace or the Bellagio. Such contracts are only currently offered on some overseas betting services, and illegal or unregulated venues in the United States.

Instead of considering venue, the Commission should consider whether the subject of the contracts involves gaming when adjudicating whether a contract involves gaming, per Kalshi's letter on the Special Rule's application.

2: Should the Commission consider taking a position on elections or congressional control is defined as gaming under state or federal law?

No, for two reasons.

First, because per the Special Rule, only the underlying event (Congressional control) should be considered in determining whether the contracts involve gaming. The application of the Special Rule with regards to this question is addressed at length in a separate comment, which also includes letters provided by our counsel, former CFTC General Counsels Jonathan Marcus and Dan Davis.¹⁷ Additional commenters on this point include former Commissioner Brian Quintenz, former Commissioner and Acting Chairman Mark Wetjen, "father of financial futures" Dr. Richard Sandor, MPD Director Josh Sterling, our director Timothy McDermott, as well as other public comments by former CFTC officials and industry actors such as Daniel Gorfine, Lewis Cohen, Tabet DiVito & Rothstein, and Jeremy Weinstein.¹⁸

Second, taking a position in an event contract is not equivalent to, as states or the federal government may define it, gaming. This is not true legally (interstate betting is illegal, and betting is illegal in many states; event contracts are legal in all jurisdictions) or in practice. As then Commissioner Quintenz wrote in his *ErisX* statement,

Whereas bettors participate in games of pure chance, whose sole purpose is to completely reward the winner and punish the loser for an outcome that would otherwise provide no economic utility (think roulette), speculators in the derivatives market participate in non-chance driven outcomes that have price forming impacts upon which legitimate businesses can hedge their activities and cash flows.¹⁹

¹⁶ McIntre, David. "They Won't Take Your Bet On The Election In Las Vegas." *FiveThirtyEight*. 2016.

¹⁷ Public comment by Elie Mishory. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70781>.

¹⁸ Public comments 70786, 69737, 69687, 70755, 69736, 70765, and 69723.

¹⁹ See Statement of Commissioner Brian D. Quintenz on ErisX RSBIx NFL Contracts and Certain Event Contracts, "Any Given Sunday in the Futures Market" (Mar. 25, 2021), available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521>

Taking a position in an event contract is also not equivalent to gaming, as defined by those laws, because such laws are not operative on CFTC-regulated products. Federal law definitions of gaming, betting, wagering carve out exemptions for CFTC-regulated products.²⁰ Many states' gaming provisions also include such exemptions.²¹ States' gaming provisions are preempted explicitly as well by the CFMA.²² Even derivatives products that are excluded or exempted from CFTC regulation still preempt state gaming and bucket shop laws per the CFMA.²³ It could not follow more plainly that CFTC-regulated derivatives have the same preemptive effect. Congress has repeatedly recognized that futures and other derivative contracts serve economic purposes and, therefore, state laws that purport to prohibit or regulate futures or derivative contracts (including gaming laws) do not violate the CEA and are preempted. All of this shows that Congress and the states understand that there is a critical distinction between betting and legitimate, federally recognized and regulated financial activity. Election contracts that are designed for price formation and hedging on a derivative exchange constitute legitimate financial activity. Therefore, it would be incorrect to give consideration of the definitions under state and federal gambling laws. As these laws themselves recognize, they do not apply to contracts like Kalshi's.

Indeed, a key purpose of the CEA and granting the CFTC exclusive jurisdiction over futures was to authorize and promote trading of futures contracts notwithstanding state laws that might purport to prohibit them as gambling. The only way in which state law is relevant is if the activity underlying the event contract violates state law, such as a contract on murder or state income tax evasion. In that case, Congress wanted to make sure that a futures contract would not legitimize that activity without the Commission considering whether trading the contract would be contrary to the public interest.²⁴

²⁰ The Unlawful Internet Gambling Enforcement Act of 2006 "do[es] not include...any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act". 31 U.S.C. § 5362(1)(E) (2006).

²¹ For example, Washington state RCW 21.30.030 clarifies that CFTC-regulated transactions are not affected by its anti-bucket shop provisions.

²² 7 USC 2(a)(1) covers exclusive CFTC jurisdiction over futures and swaps, so any state laws that would purport to regulate or prohibit futures or swaps would be preempted.. The CEA also preempts state gaming laws with respect to derivative products that are excluded or exempt from the CEA. *See* 7 USC 16(e)(2) ("This Act shall supersede and preempt the application of any State or local law that prohibits or regulates gaming or the operation of bucket shops . . . in the case of --- (A) an electronic trading facility excluded under section 2(e) of this Act; and (B) an agreement, contract, or transaction that is excluded from this Act under [provisions of] the Commodity Futures Modernization Act of 2000, or exempted under section 4(c) of this Act.").

²³ *Ibid*

²⁴ Congress obviously would not be concerned about legitimizing elections. Even if the focus comes to legitimizing the trading on elections as part of the ultimate public interest analysis, the Commission has already crossed that bridge by long permitting market participants to trade such contracts pursuant to no action letters awarded to unregulated markets. The notion that allowing a regulated exchange to offer the contracts is what changes the public interest analysis is insupportable.

As for the federal prohibition on interstate betting, the Wire Act is irrelevant here—it applies only to sports betting and wagering. Moreover, when Congress most recently addressed the intersection of gambling/gaming and the Internet, it carved out derivatives contracts (both on exchange and over the counter) from the definition of betting and wagering, thereby plainly recognizing that derivatives contracts serve economic purposes that distinguish them from gambling/gaming.²⁵ Congress recognized this much earlier too, granting the CFTC exclusive jurisdiction over futures as noted above and expressly preempting state gaming laws in the CFMA.²⁶

Additionally, many broad state gambling laws would define all event contracts as gaming, as well as many other futures, swaps, and options. States like New Hampshire, for example, define gambling as having “to risk something of value upon a future contingent event not under one's control or influence.”²⁷ If the Commission were to find that the contracts involve gaming on the theory that New Hampshire state law prohibit gambling/wagering on elections, that would mean “wagering” is equivalent to taking a position on any event contract, which in turn would require that the Special Rule is triggered by *any* event contract because many New Hampshire’s and many other state’s gambling laws prohibit wagering on the outcome of *any* future event. That interpretation was clearly not Congress’ intent. Instead, Congress narrowly defined a small number of event contracts whose underlying event involves an unsavory activity that Congress did not want the CFTC to legitimize without evaluating whether trading a contract on that activity would be contrary to the public interest (as per the text, which isolates a selected set of enumerated events to target).

Time and time again, Congress and states have indicated that the Commission has the decision making power over derivatives market issues, including event contracts, and approval of Kalshi’s contract has no involvement with gaming any more than an event contract on the growth of Gross Domestic Product or whether a bill becomes law. If the Commission chooses to isolate

²⁵ The Unlawful Internet Gambling Enforcement Act of 2006 “do[es] not include...any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act”. 31 U.S.C. § 5362(1)(E) (2006).

²⁶ 7 USC 2(a)(1) covers exclusive CFTC jurisdiction over futures and swaps, so any state laws that would purport to regulate or prohibit futures or swaps would be preempted.. The CEA also preempts state gaming laws with respect to derivative products that are excluded or exempt from the CEA. See 7 USC 16(e)(2) (“This Act shall supersede and preempt the application of any State or local law that prohibits or regulates gaming or the operation of bucket shops . . . in the case of --- (A) an electronic trading facility excluded under section 2(e) of this Act; and (B) an agreement, contract, or transaction that is excluded from this Act under [provisions of] the Commodity Futures Modernization Act of 2000, or exempted under section 4(c) of this Act.”).

²⁷ New Hampshire Rev Stat § 647:2(II)(d) (2017); see also Alaska Stat. § 11.66.280(3) (“gambling” means that a person stakes or risks something of value upon the outcome of a contest of chance or a future contingent event not under the person's control or influence, upon an agreement or understanding that that person or someone else will receive something of value in the event of a certain outcome”); Oregon Rev. Stat. § 167.117(7) (“‘Gambling’ means that a person stakes or risks something of value upon the outcome of a contests of chance or a future contingent event not under the control or influence of the person . . .”).

these contracts as involving gaming but not those many others, it would be acting contrary to Commission precedent and in an arbitrary way.

4. Do these contracts involve, relate to, or reference “an activity that is unlawful under any State or Federal law” as described in Commission regulation 40.11(a)(1) and section 5c(c)(5)(C) of the Commodity Exchange Act?

No. The contracts solely involve the partisan affiliation of the Speaker of the U.S. House of Representatives and the President *pro tempore* of the U.S. Senate.

The contracts also do not involve unlawful activity because of state prohibitions against election ‘wagering’ or ‘betting’, or federal laws prohibiting interstate ‘betting’. Two arguments below explain why.

First, because per the Special Rule, only the underlying event (Congressional control) should be considered in determining whether the contracts involve gaming. The application of the Special Rule with regards to this question is addressed at length in a separate comment, which also includes letters provided by our counsel, former CFTC General Counsels Jonathan Marcus and Dan Davis.²⁸ Additional commenters on the matter include former MPD Director Josh Sterling, our director Timothy McDermott, as well as other public comments by former CFTC officials and industry actors such as Daniel Gorfine, Lewis Cohen, Tabet DiVito & Rothstein, and Jeremy Weinstein.²⁹

Second, taking a position in an event contract is not equivalent to, as states or the federal government may define it, ‘wagering’ or ‘betting’ which they prohibit. This is not true legally (interstate betting is illegal, and betting is illegal in many states; event contracts are legal in all jurisdictions) or in practice.

Taking a position in an event contract is also not equivalent to the unlawful activity such laws refer to, because such laws are not operative on CFTC-regulated products. Federal law definitions of gaming, betting, wagering carve out exemptions for CFTC-regulated products.³⁰ Many states’ gaming provisions also include such exemptions.³¹ States’ gaming provisions are preempted explicitly as well by the CFMA.³² Even derivatives products that are excluded or

²⁸ Public comment by Elie Mishory. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70781>.

²⁹ Public comments 69737, 69687, 70755, 69736, 70765, and 69723.

³⁰ The Unlawful Internet Gambling Enforcement Act of 2006 “do[es] not include...any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act”. 31 U.S.C. § 5362(1)(E) (2006).

³¹ For example, Washington state RCW 21.30.030 clarifies that CFTC-regulated transactions are not affected by its anti-bucket shop provisions.

³² 7 USC 2(a)(1) covers exclusive CFTC jurisdiction over futures and swaps, so any state laws that would purport to regulate or prohibit futures or swaps would be preempted.. The CEA also preempts state gaming laws with respect

exempted from CFTC regulation still preempt state gaming and bucket shop laws per the CFMA.³³ It could not follow more plainly that CFTC-regulated derivatives have the same preemptive effect. Congress has repeatedly recognized that futures and other derivative contracts serve economic purposes and, therefore, state laws that purport to prohibit or regulate futures or derivative contracts (including gaming laws) do not violate the CEA and are preempted. All of this shows that Congress and the states understand that there is a critical distinction between betting and legitimate financial activity. Election contracts that are designed for hedging on a financial market constitute legitimate financial activity. Therefore, it would be incorrect to consider the contracts as involving unlawful activity. As these laws themselves recognize, they do not apply to contracts like Kalshi's.

A key purpose of the CEA and granting the CFTC exclusive jurisdiction over futures was to authorize and promote trading of futures contracts notwithstanding state laws that might purport to prohibit them as gambling. The only way in which state law is relevant is if the activity underlying the event contract violates state law, such as a contract on murder or state income tax evasion.³⁴ In that case, Congress wanted to make sure that a futures contract would not legitimize that blatantly illegal activity without the Commission considering whether trading the contract would be contrary to the public interest.³⁵

As for the federal prohibition on interstate betting, the Wire Act is irrelevant here—it applies only to sports betting and wagering. Moreover, when Congress most recently addressed the intersection of gambling/gaming and the Internet, it carved out derivatives contracts (both on exchange and over the counter) from the definition of betting and wagering, thereby plainly recognizing that derivatives contracts serve economic purposes that distinguish them from gambling/gaming.³⁶ Congress recognized this much earlier too, granting the CFTC exclusive jurisdiction over futures as noted above and expressly preempting state gaming laws in the CFMA.³⁷

to derivative products that are excluded or exempt from the CEA. *See* 7 USC 16(e)(2) ("This Act shall supersede and preempt the application of any State or local law that prohibits or regulates gaming or the operation of bucket shops . . . in the case of --- (A) an electronic trading facility excluded under section 2(e) of this Act; and (B) an agreement, contract, or transaction that is excluded from this Act under [provisions of] the Commodity Futures Modernization Act of 2000, or exempted under section 4(c) of this Act.").

³³ *Ibid*

³⁴ We note some commenters have compared these contracts as equivalent, hypothetically, to contracts on mass shootings. The analogy is clearly incorrect and is a gross misinterpretation of the statute.

³⁵ Congress obviously would not be concerned about legitimizing elections. Even if the focus comes to legitimizing the trading on elections as part of the ultimate public interest analysis, the Commission has already crossed that bridge by long permitting market participants to trade such contracts pursuant to no action letters awarded to unregulated markets. The notion that allowing a regulated exchange to offer the contracts is what changes the public interest analysis is insupportable.

³⁶ The Unlawful Internet Gambling Enforcement Act of 2006 "do[es] not include...any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act". 31 U.S.C. § 5362(1)(E) (2006).

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Additionally, many broad state gambling laws would define all event contracts as gaming, as well as many other futures, swaps, and options. States like New Hampshire, for example, define gambling as having “to risk something of value upon a future contingent event not under one's control or influence.”³⁸ If the Commission were to find that the contracts involve unlawful activity on the theory that there are state laws (or a federal law) prohibiting gambling/wagering on elections, and that wagering is equivalent to taking a position on an event contract, that would mean that the Special Rule is triggered by *any* event contract because many state gambling laws prohibit wagering on the outcome of *any* future event. That interpretation was clearly not Congress’ intent. Instead, Congress narrowly defined a small number of event contracts whose underlying event involves an unsavory activity that Congress did not want the CFTC to legitimize without evaluating whether trading a contract on that activity would be contrary to the public interest (as per the text, which isolates a selected set of enumerated events to target).

Time and time again, Congress and states have indicated that the Commission has the decision making power here and approval of Kalshi’s contracts has no involvement with unlawful activity any more than an event contract on Gross Domestic Product or whether a bill becomes law. If the Commission chooses to isolate these contracts as involving unlawful activity but not those many others, it would be acting contrary to Commission precedent and in an arbitrary way.

5. In determining whether these contracts involve an activity that is unlawful under any State or Federal law, should the Commission be influenced by whether state laws permit betting on the outcome of elections or other political outcomes and/or by the prohibition of interstate betting under Federal law?

No. The contracts solely involve the partisan affiliation of the Speaker of the U.S. House of Representatives and the President *pro tempore* of the U.S. Senate.

This issue was addressed in the previous question’s response. It has been copied here for ease. The contracts also do not involve unlawful activity because of state prohibitions against election

to derivative products that are excluded or exempt from the CEA. *See* 7 USC 16(e)(2) (“This Act shall supersede and preempt the application of any State or local law that prohibits or regulates gaming or the operation of bucket shops . . . in the case of --- (A) an electronic trading facility excluded under section 2(e) of this Act; and (B) an agreement, contract, or transaction that is excluded from this Act under [provisions of] the Commodity Futures Modernization Act of 2000, or exempted under section 4(c) of this Act.”).

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‘wagering’ or ‘betting’, or federal laws prohibiting interstate ‘betting’. Two arguments below explain why.

First, because per the Special Rule, only the underlying event (Congressional control) should be considered in determining whether the contracts involve gaming. The application of the Special Rule with regards to this question is addressed at length in a separate comment, which also includes letters provided by our counsel, former CFTC General Counsels Jonathan Marcus and Dan Davis.³⁹ Additional commenters on the matter include former MPD Director Josh Sterling, our director Timothy McDermott, as well as other public comments by former CFTC officials and industry actors such as Daniel Gorfine, Lewis Cohen, Tabet DiVito & Rothstein, and Jeremy Weinstein.⁴⁰

Second, taking a position in an event contract is not equivalent to, as states or the federal government may define it, ‘wagering’ or ‘betting’ which they prohibit. This is not true legally (interstate betting is illegal, and betting is illegal in many states; event contracts are legal in all jurisdictions) or in practice. As “father of futures” Dr. Richard Sandor wrote in his comment letter,

A major misconception that still prevails among the public is the equivalence of gambling and speculation. Nothing could be farther from the truth. Gambling is an artificial, self-constructed risk created for recreation. Speculation is the assumption of risks that already exist in the real and financial markets. The recreational risk of gambling is not present until the casino or racetrack is built and wagers are accepted. On the other hand, risk in the production of good and services in the economy are real and will exist even in the absence of futures markets. The same can be said for equity and interest rate and risk. It seems reasonable to conclude the risks associated with policy changes from different election outcomes are most similar to the latter. The transfer of risk by hedgers would be real and the assumption of that risk by speculators would be proper.⁴¹

Taking a position in an event contract is also not equivalent to the unlawful activity such laws refer to, because such laws are not operative on CFTC-regulated products. Federal law definitions of gaming, betting, wagering carve out exemptions for CFTC-regulated products.⁴² Many states’ gaming provisions also include such exemptions.⁴³ States’ gaming provisions are

³⁹ Public comment by Elie Mishory. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70781>.

⁴⁰ Public comments 69737, 69687, 70755, 69736, 70765, and 69723.

⁴¹ Public comment by Richard Sandor. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70792>.

⁴² The Unlawful Internet Gambling Enforcement Act of 2006 “do[es] not include...any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act”. 31 U.S.C. § 5362(1)(E) (2006).

⁴³ For example, Washington state RCW 21.30.030 clarifies that CFTC-regulated transactions are not affected by its anti-bucket shop provisions.

preempted explicitly as well by the CFMA.⁴⁴ Even derivatives products that are excluded or exempted from CFTC regulation still preempt state gaming and bucket shop laws per the CFMA.⁴⁵ It could not follow more plainly that CFTC-regulated derivatives have the same preemptive effect. Congress has repeatedly recognized that futures and other derivative contracts serve economic purposes and, therefore, state laws that purport to prohibit or regulate futures or derivative contracts (including gaming laws) do not violate the CEA and are preempted. All of this shows that Congress and the states understand that there is a critical distinction between betting and legitimate financial activity. Election contracts that are designed for hedging on a financial market constitute legitimate financial activity. Therefore, it would be incorrect to consider the contracts as involving unlawful activity. As these laws themselves recognize, they do not apply to contracts like Kalshi's.

A key purpose of the CEA and granting the CFTC exclusive jurisdiction over futures was to authorize and promote trading of futures contracts notwithstanding state laws that might purport to prohibit them as gambling. The only way in which state law is relevant is if the activity underlying the event contract violates state law, such as a contract on murder or state income tax evasion. In that case, Congress wanted to make sure that a futures contract would not legitimize that activity without the Commission considering whether trading the contract would be contrary to the public interest.⁴⁶

As for the federal prohibition on interstate betting, the Wire Act is irrelevant here—it applies only to sports betting and wagering. Moreover, when Congress most recently addressed the intersection of gambling/gaming and the Internet, it carved out derivatives contracts (both on exchange and over the counter) from the definition of betting and wagering, thereby plainly recognizing that derivatives contracts serve economic purposes that distinguish them from gambling/gaming.⁴⁷ Congress recognized this much earlier too, granting the CFTC exclusive

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⁴⁵ *Ibid*

⁴⁶ Congress obviously would not be concerned about legitimizing elections. Even if the focus comes to legitimizing the trading on elections as part of the ultimate public interest analysis, the Commission has already crossed that bridge by long permitting market participants to trade such contracts pursuant to no action letters awarded to unregulated markets. The notion that allowing a regulated exchange to offer the contracts is what changes the public interest analysis is insupportable.

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jurisdiction over futures as noted above and expressly preempting state gaming laws in the CFMA.⁴⁸

Additionally, many broad state gambling laws would define all event contracts as gaming, as well as many other futures, swaps, and options. States like New Hampshire, for example, define gambling as having “to risk something of value upon a future contingent event not under one's control or influence.”⁴⁹ If the Commission were to find that the contract involve unlawful activity on the theory that there are state laws (or a federal law) prohibiting gambling/wagering on elections, and that wagering is equivalent to taking a position on an event contract, that would mean that the Special Rule is triggered by *any* event contract because many state gambling laws prohibit wagering on the outcome of *any* future event. That interpretation was clearly not Congress’ intent. Instead, Congress narrowly defined a small number of event contracts whose underlying event involves an unsavory activity that Congress did not want the CFTC to legitimize without evaluating whether trading a contract on that activity would be contrary to the public interest (as per the text, which isolates a selected set of enumerated events to target).

Time and time again, Congress and states have indicated that the Commission has the decision making power here and approval of Kalshi’s contract has no involvement with unlawful activity any more than an event contract on Gross Domestic Product or whether a bill becomes law. If the Commission chooses to isolate these contracts as involving unlawful activity but not those many others, it would be acting contrary to Commission precedent and in an arbitrary way.

6. Are the contracts substantively different from Nadex’s previously proposed political event contracts such that the Commission’s analysis should be different? For reference, please see “CFTC Order Prohibiting North American Derivatives Exchange’s Political Event Derivatives Contracts” (Apr. 2, 2012), available at <https://www.cftc.gov/PressRoom/PressReleases/6224-12>.

There are a number of important distinctions between these Contracts and the Nadex contracts: (i) the contemporary understanding of the contracts’ value, economic and otherwise, is more

⁴⁸ 7 USC 2(a)(1) covers exclusive CFTC jurisdiction over futures and swaps, so any state laws that would purport to regulate or prohibit futures or swaps would be preempted.. The CEA also preempts state gaming laws with respect to derivative products that are excluded or exempt from the CEA. See 7 USC 16(e)(2) (“This Act shall supersede and preempt the application of any State or local law that prohibits or regulates gaming or the operation of bucket shops . . . in the case of --- (A) an electronic trading facility excluded under section 2(e) of this Act; and (B) an agreement, contract, or transaction that is excluded from this Act under [provisions of] the Commodity Futures Modernization Act of 2000, or exempted under section 4(c) of this Act.”).

⁴⁹ New Hampshire Rev Stat § 647:2(II)(d) (2017); see also Alaska Stat. § 11.66.280(3) (“gambling” means that a person stakes or risks something of value upon the outcome of a contest of chance or a future contingent event not under the person's control or influence, upon an agreement or understanding that that person or someone else will receive something of value in the event of a certain outcome”); Oregon Rev. Stat. § 167.117(7) (“‘Gambling’ means that a person stakes or risks something of value upon the outcome of a contests of chance or a future contingent event not under the control or influence of the person . . .”).

robust, (ii) there is data available to the Commission today that was not available to it in 2012 to assist its assessment of the Contracts' economic purpose and hedging utility. It was for these reasons that Mark Wetjen, former Commissioner and Acting Chairman and who served when the agency ruled against Nadex, supports Kalshi's submission.⁵⁰

First, the understanding of the scope and significance of how market participants face risk from elections and attempt to hedge and manage their risks is much greater today than it was when the Commission considered Nadex's contracts. Today, news articles frequently discuss election risk and limited hedging opportunities.⁵¹ Studies and commenters have discussed how banks engage in such hedging, both using traditional instruments and over-the-counter products.⁵² In recent years, CEOs use the word 'election' at very high rates on earnings calls near election time.⁵³ Additionally, there is now data on the correlation between perceived election outcomes and pricing of financial assets that were not available when the Commission considered Nadex. Many researchers utilized data from PredictIt to study the link between market based election outcome pricing, along with election polling and the impact on pricing financial assets.⁵⁴ They also consistently found that it was often more dynamic and accurate than polling.⁵⁵ These findings by academics have been replicated many times, as described in Kalshi's original submission at length.

Second, the understanding of the public interest factors of the contracts is very different today than it was when the Commission considered the Nadex contracts. Victoria University of Wellington's operation of its exchange pursuant to a CFTC no-action letter provided evidence and data from trading on these markets and other similar markets (including more local markets) over a period of close to eight years. PredictIt has traded more than a billion shares.⁵⁶ Its markets were consistently referenced, in real time and in hindsight, as informative and useful by major news organizations like *CNN*, *CNBC*, *Politico*, *Bloomberg*, *The Economist*, *The Wall Street Journal*, *The Washington Post*, and across various sections of *The New York Times* like *The*

⁵⁰ Public comment by Mark Wetjen. Available at

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70771>.

⁵¹ There are too many examples to cite. Some can be found at Refinitiv ("A US Election Hedge"), Barron's ("This Election Could Be Really Weird. Hedge Your Portfolio"), or Yahoo Finance ("How To Hedge Your Portfolio For The Election"), all from the last 5 years. Available at:

<https://www.refinitiv.com/en/the-big-conversation/episode-48-a-us-election-hedge>,

<https://www.barrons.com/articles/this-election-could-be-really-weird-hedge-your-portfolio-51599130801>, and

<https://finance.yahoo.com/news/hedge-portfolio-election-173325198.html>.

⁵² Public comment by Angelo Lisboa. Available at

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69666>.

⁵³ John Butters. 2020. "More than one third of S&P 500 companies are discussing the election on Q3 earnings calls." Factset.

⁵⁴ Such as Snowberg, Zitzewitz, and Wolfers (2006); Zitzewitz and Wolfers (2016); and Jayachandran (2016).

Available at: <https://www.frbsf.org/economic-research/publications/working-papers/2006/08/>,

<https://www.brookings.edu/research/what-do-financial-markets-think-of-the-2016-election/>, and

<https://escholarship.org/content/qt25p4z52g/qt25p4z52g.pdf?t=krmnet>.

⁵⁵ Miller, Thomas W. "Predicting the 2020 Presidential Election." *Data Science Quarterly*. 2021.

⁵⁶ LinkedIn profile of Will Jennings, former PredictIt employee. <https://www.linkedin.com/in/will-jennings-pi>

Upshot, *DealBook*, opinion columns, and the technology section. The reliance on PredictIt demonstrates the public's interest and social value in its data across all spectrums of society. In addition, information generated from PredictIt's markets was repeatedly cited by prominent political officials and commentators. Examples include economists like Jason Furman, previously President Obama's Council of Economic Advisors Chair (who submitted a supportive comment letter which noted PredictIt's election market data was used while he was in the White House); Nobel Laureate Paul Krugman, a Professor at Graduate Center, CUNY and a columnist for *The New York Times*; and data scientists/reporters like Nate Silver, founder and editor-in-chief of *FiveThirtyEight*.⁵⁷⁵⁸ All of this strong support for the contract's public interest was not available to the Commission when it considered Nadex.

Additionally, the fears driving the *Nadex Order* with respect to election integrity—that voters could be incentivized to switch votes given election markets—has never been realized or suggested. The complete lack of evidence for the concern in the *Nadex Order*, despite a massive growth in election trading post-*Nadex*, is highly probative. PredictIt traded over 1.2 billion shares from 2014 to the present.⁵⁹ U.S. elections traded around \$250 million between off-shore exchanges like InTrade and BetFair in 2012; by 2020, PredictIt and Betfair alone combined for nearly \$1b in trading.⁶⁰ The Commission's fear, speculative at the time, has been rebutted through recent history with materially similar market activity. For these reasons, the Commission's past – and speculative – concern that approving the Nadex contracts would create monetary incentives to vote for a particular candidate cannot be relied on again.

Finally, these markets have grown dramatically despite the *Nadex Order*. The public is very interested in the information provided by these markets, even when that information comes from unregulated or offshore sources. While market demand for a product is not sufficient alone to determine the public interest, it is undeniably an important factor that the Commission should consider in determining whether a contract is contrary to that interest. It is unlikely that the Commission would disagree that its many Core Principles and regulatory oversight lead to a safer market experience for participants. Accordingly, there is significant public interest in having these markets available on regulated exchanges.

Similarly, especially with regard to Congressional control contracts, it is important that market activity not be a detrimental or negative force. There are obvious benefits to market activity occurring under the sanitizing light of regulation—as Justice Louis Brandeis said, “sunlight is said

⁵⁷ Public comment letter by Jason Furman. Available at:

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69708>.

⁵⁸ For the sake of brevity, a full list of citations in this section can be found at the end of this document.

⁵⁹ LinkedIn profile of Will Jennings, former PredictIt employee. <https://www.linkedin.com/in/will-jennings-pi>

⁶⁰ Full breakdown of volume at end of document.

to be the best disinfectants.”⁶¹ The demonstrated rapid growth of this activity is unlikely to abate absent significant actions from the Commission to *prevent* the activity, a tall task given constrained Commission resources, the breadth of these markets, and the ease of their creation. Accordingly, these markets will likely continue to exist. The question is whether they will exist also in a regulated market or remain just in the unregulated shadow market. This is of course not a reason to permit the contracts *independently* of the Contract’s economic utility. But it is an undeniably important public interest consideration. Because the breadth of the current unregulated marketplace is a more recent development, this public interest consideration was not before the Commission when it considered Nadex.

The Exchange also notes that exchanges are not granted exclusive licenses to list products. If the Commission would allow these contracts, Nadex would generally be able to list the same contracts Kalshi is proposing today.

7. Are the contracts substantively different from Kalshi’s previously proposed, and withdrawn, congressional control contracts? For reference, please see “CFTC Announces Review and Comment Period of KalshiEX Proposed Congressional Control Contracts Under CFTC Regulation 40.11” (August 26, 2022), available at <https://www.cftc.gov/PressRoom/PressReleases/8578-22>.

Kalshi’s contract was modified in response to Commission questions, the public comments, and Commission staff feedback. There are three changes to the contract:

1. An increase in the position limits from \$25,000 for all participants to a tiered system for retail, institutions, and eligible contract participants that allows for potentially much higher limits.
2. An increase in the order size to 5000 contracts, from 1.
3. A list of political actors who are prohibited from trading were detailed.

Whether the proposed contract is “substantively different” is a semantic matter. The contract serves broadly the same economic purpose but has been more narrowly tailored to promote *bona fide* hedging behavior and gate out potential insiders. In practice, the contract will be used less by smaller retail users compared to the previous submission. Kalshi’s previous submission is still compliant with the Core Principles and the Act, and would serve the public interest by virtue of its hedging, price basing, and forecasting benefits.

What is clear and obvious is that this contract that is before the Commission, like the prior contract, can be used to hedge risk exposure to political control, and will serve as a price

⁶¹ Brandeis, Louis. “What Publicity Can Do.” 1914. Accessed via the website of the Louis D. Brandeis School of Law Library. Available at <https://louisville.edu/law/library/special-collections/the-louis-d.-brandeis-collection/other-peoples-money-chapter-v>

discovery tool for the market's pricing of the likelihood of the various outcomes of political control.

Further, just as the Special Rule for Event Contracts does not apply to the prior contract because the underlying event is not one of the enumerated events, so too it does not apply to this contract.

8. Do the contracts serve a hedging function? What standard should be used in reviewing the contracts' hedging function? Is it sufficient that a contract could theoretically be used for hedging, or should an exchange provide evidence of demonstrated need by likely hedgers in the market? How often must a contract be used for hedging or what percentage of market participants or open interest must represent hedging use in order for a contract to serve a hedging function?

Yes, the contracts serve a hedging function. The financial press frequently reports on how elections (and changes in election polling, no less) affect the prices of financial assets, well before any laws by the new Congress have been enacted.⁶²⁶³⁶⁴ Academic research consistently finds a link between movements in election prediction markets and financial assets, as well as between polls and financial assets.⁶⁵ Even though the exact consequences of elections are not certain, political parties make sufficiently credible commitments to changing government policies in a manner that market participants currently believe are predictable enough—they're already pricing in the risk and putting money on the line.

The remaining elements of the question can be unpacked as follows:

1. An assumption that the Commission should review a contract's hedging function.
2. Should the standard for hedging be theoretical use or demonstrated need?
 - a. Must a contract's participants have a minimum required amount of hedging (either in absolute or percentage terms)?

The Exchange will address these seriatim. However, the Exchange notes that regardless of the standard, the contracts here passes: *Kalshi has demonstrated hedging need*. In its submission to DMO in March 2022, Kalshi provided many examples of consistent evidence of ongoing hedging in the public and private markets via testimony from market participants and academia. Many retail investors, small businesses, billion-dollar businesses, and members of industry provided comments testifying to their personal hedging use cases. These included those by Alex

⁶² Noel Randewich. 2020. "S&P 500 futures rise as U.S. election suggests less regulatory risk." Reuters.

⁶³ Myra P. Saefong. 2020. "Here's how the U.S. presidential election could shake up the oil market." Marketwatch.

⁶⁴ Matthew Weaver. 2020. "Congressional elections could impact commodity prices most, expert says." *Capital Press*.

⁶⁵ Such as Snowberg, Zitzewitz, and Wolfers (2006); Zitzewitz and Wolfers (2016); and Jayachandran (2016).

Available at: <https://www.frbsf.org/economic-research/publications/working-papers/2006/08/>,

<https://www.brookings.edu/research/what-do-financial-markets-think-of-the-2016-election/>,

<https://escholarship.org/content/qt25p4z52g/qt25p4z52g.pdf?t=kmmet>.

Keeney, Ali Partovi, Arvind S, Jun Sup Lee, Edward Makino, Ramin Ahmari, Valentin Perez, Donald Stalter, Alexander King, Kenn Butler, Vivek Ranadive, Thomas Dalton Combs, among so many others.⁶⁶

There is nothing more Kalshi and potential hedgers could have done in order to demonstrate the hedging need this product fills.

1: Should the Commission review a contract's hedging function?

There is no requirement from Congress, nor mechanism by which, the Commission can or should determine hedging utility as a metric on its own outside of the public interest. However, a contract's hedging utility can be considered as supporting the public interest as part of the public interest consideration should the Commission find that a contract involves one of the enumerated activities of the Special Rule.

2: What standard should the Commission use, theoretical use or demonstrated need?

A contract's hedging utility may be an important consideration in favor of finding that a contract is not contrary to the public interest should the Commission find that it involves one of the enumerated activities of the Special Rule. Hedging is in the public interest and promoting risk mitigation is a core mission of the CFTC. The Exchange notes, however, that these two suggestions ('theoretical' versus 'demonstrated need') are more like opposite ends of a spectrum, and there are variations in between.

It should use a theoretical use standard. A demonstrated need standard could inhibit the creation of new products with smaller or less clear markets; has no clear mechanism by which it can be determined; and because a contract only theoretically being used for hedging is not contrary to the public interest.

It should not be missed that the standard implied in the last part of this question (some minimum required amount of hedging, in absolute or percentage terms) would be likely to have unintended consequences if imposed on the market.

1. This standard has not been imposed on *any other contract in Commission history*, including any event contract. There are only 90 million barrels of oil produced per day, but almost 1 billion barrels are traded on Chicago Mercantile Exchange's crude oil futures every day (not to mention other highly traded products, like Intercontinental Exchange's West Texas Intermediate or Brent contracts).⁶⁷ The overwhelming majority of

⁶⁶ See comments 69612, 69608, 69671, 69647, 69696, 69669, 69725, 70770, 69709, 70776, 70757, 70767.

⁶⁷ CME Crude Oil Futures Volume & Open Interest. Available at <https://www.cmegroup.com/markets/energy/crude-oil/light-sweet-crude.volume.html>.

activity is not primary hedgers. Nonetheless, the market has clearly added value to the global financial system.

2. The percentage of the Contract's participants hedging will no doubt vary over time in a vibrant, dynamic marketplace as risks change.
3. Speculation is an accepted important use case for all contracts in the financial markets. Speculation on events of economic purpose is not equivalent to gaming or gambling, and has never been considered that. Non-hedgers help balance out any differences between short and long hedgers, and provide liquidity to the hedgers themselves. Without speculation, none of the major futures and derivatives markets would be as liquid as they are today, and thus as powerful in fulfilling the hedging utility as they are. Speculation improves a contract's hedging utility. Even in cases where the non-hedgers are not actually matching on the exchange with the hedgers, they are providing a valuable service to the hedgers. The price offered on an exchange is a function of many factors, including demand and liquidity—non-hedgers will demand a greater premium if they know it will be harder for them to exit their positions later if their needs change. So the presence of later non-hedgers willing to provide liquidity and trading volume is essential to encouraging the original round of liquidity providers to offer more competitive prices to the hedgers, since the original liquidity providers know that they will not have an issue exiting their positions later. As Commissioner Quintenz put it:

Whereas bettors participate in games of pure chance, whose sole purpose is to completely reward the winner and punish the loser for an outcome that would otherwise provide no economic utility (think roulette), speculators in the derivatives market participate in non-chance driven outcomes that have price forming impacts upon which legitimate businesses can hedge their activities and cash flows... The other factor which makes speculation different than pure-chance gambling is the price forming impact it has on markets which allow businesses to hedge their risk.⁶⁸

9. Are there unique economic risks tied to the outcome of congressional control that cannot be hedged via derivative products on equities, debt, interest rates, tax rates, asset values, and other commodity prices?

The Commission's question can be taken to imply two different things, either that the other products are linked directly on the same risks that the contracts would be used for hedging, or that market participants can reasonably approximate the Contract's hedging utility via a melange of other instruments.

Assuming the former, the answer is yes, there are risks that cannot be currently hedged. First, as noted by Hehmeyer and other commenters, and in the Exchange's submission, there are significant direct, non-policy related economic risks, such as the risks imposed by political

⁶⁸ Quintenz, *ErisX*.

outcomes on the fortunes of media personalities, media consultants, and others with connections and ties to the party in power. These risks cannot be otherwise hedged by traditional products.

As discussed earlier, changes in general risk that a certain Congress could pose to various industries can be discerned well in advance of knowledge of the particular policies that may be implemented by that Congress and provide just as valid a hedging rationale. This difference results from the time horizon between the election cycle and the implementation of a new Congress' specific legislative agenda or its potential responses to current events. For example, following the election of Republicans into Congress in 2016, many publications speculated that trade policy would become more restrictive; however, it was not known if this would come in the form of new trade deals, re-negotiating existing trade agreements, new tariffs (and if so, on what goods and at what level), international lawsuits, and more. Another event contract or future on taxes or public policy would not have been very helpful. However, the risk of a more restrictive policy was there because of who would win the election, exactly what Kalshi's contracts allow traders to hedge.

Another example is new legislation that would burden a market participant. Once the legislation draft is released, the impact will begin to be felt immediately (on assets, cash flows, and partnerships as market participants price in risk), making a hedge useless; the downside risk has already had much of its effect. Markets are forward looking, and hedging products should reflect that. Even just a statement by a politician can be very damaging for firms.⁶⁹

Additionally, a single market participant may face myriad risks from elections. Many firms and individuals are negatively affected by a suite of a party's policies, and thus wish to hedge the many different changes in risk through a single contract. For example, an oil company may wish to hedge the risk that a new Democratic government will come into office, because that government could not only impose new regulations on them but also change the composition of existing regulatory bodies and increase their labor costs (through raising the minimum wage, supporting unionization, or mandating greater health care benefits for employees). Only Kalshi's proposal lets them hedge the risk they actually face: Democratic government.

If the question is asking instead whether market participants can reasonably approximate the Contract's hedging utility via a melange of other instruments, the answer is they cannot. Many retail and small business market participants do not have access to these other instruments, and the inherent friction and transaction costs in arranging these types of complex proxy plays is prohibitive. It seems unlikely that the Commission would determine it in the public interest to solely rely on these tools that are inaccessible to many of the market participants who need risk management tools most. Additionally, the effectiveness of these baskets and combination of

⁶⁹ White, Spencer. "Hillary Clinton Blog Post Hits Valeant Stock For 9% Loss Without Revealing New Policy." Yahoo Finance. 2016.

instruments to hedge the risk from political control is considerably less than a contract directly on political control.

Importantly, the question implies that its answer matters, but does not explain why it would. A reasonable inference is that the Commission is saying no new method of hedging a risk should be permitted if there are other existing methods of hedging that risk. Nowhere in the CEA or the Commission's Regulations is there such a standard. The Exchange hopes this is not the Commission's view, as it has not been the Exchange's experience when engaging with the Commission on prior contracts. For example, should the Commission say "farmers can buy crop insurance therefore they should not have access to agricultural futures products"?

Furthermore, such an interpretation would be highly anti-competitive. Such an interpretation would mean that if one firm offers a contract on an event or a commodity, that no challenger should enter the market with a similar but different product to compete with it. In fact, such an interpretation would consistently punish novel or innovative products – in many cases, it is possible to construct a hedge using existing products, and attempting to do so might be expensive or incur excess basis risk. The fact that election risk has implications for other assets is, in fact, much of the justification *for* the contract's hedging utility and would work in concert with such assets. Many similar and competing products are listed by different exchanges in order to promote a vibrant and competitive marketplace for hedgers. This is also an important component of the contract's price discovery utility, discussed in a later question.

Such an interpretation would also curtail innovation. Innovation often happens through iterating on already successful products and ideas. As in the earlier example, the existence of insurance products would have inhibited the creation of futures. Innovation often requires creating new, and sometimes flawed, products in order to try and optimize use cases for market participants. Hedgers benefit when many exchanges are launching many different products to try and tailor to their needs; they suffer when the government limits their options. It's in the public interest for such innovation to occur, and for that to happen, the Commission should not take the view that this product should not be listed because it purportedly can be hedged through other means.

10. Are the economic consequences of congressional control predictable enough for a contract based on that control to serve a hedging function? Please provide tangible examples of commercial activity that can be hedged directly by the contracts or economic analysis that demonstrates the hedging utility of the contracts.

Yes. The financial press frequently reports on how elections (and changes in election polling, no less) affect the prices of financial assets, well before any laws by the new Congress have been

enacted.⁷⁰⁷¹⁷² Academic research consistently finds a link between movements in election prediction markets and financial assets, as well as between polls and financial assets.⁷³ Even though the exact consequences of elections are not certain, political parties make sufficiently credible commitments to changing government policies in a manner that market participants currently believe are predictable enough—they're already pricing in the risk and putting money on the line.

Investment banks routinely provide clients with advice on hedging through their private wealth divisions. This was described in a comment letter provided by a Managing Director of JPMorgan Chase. He wrote,

At JPMorgan, election risk is one of the largest risks our clients face, and they frequently engage us proactively on how to minimize it (hedge it, in other words). We work with and advise our clients on how to avoid that risk in their portfolios, especially when a client's cash flows or investments are very politically sensitive (for example, those in the coal industry are very concerned regarding election outcomes and policy expectations).

Since clients have different risk profiles, we do extensive research to fine-tune how these risks add up in our clients' positions. Our division employs a team of economists, at service to our partners, whose role in election years is heavily to research election probabilities as well as the impact election outcomes will have on equities and other investment products. We frequently host discussions with experts and clients on the relevant risks (including one coming up this week!) and publish research for both clients and the public.⁷⁴

Investment banks also publish research to money managers (and the public, as the above mentions) that provides advice on how to hedge election risk in very specific ways. For example, JP Morgan Chase projected that a Democratic victory in 2020 would lead to a rally in 'left-behind' equities, such as "European cyclical, value, China-exposed stocks and renewables" and portfolios should be adjusted accordingly.⁷⁵

⁷⁰ Noel Randewich. 2020. "S&P 500 futures rise as U.S. election suggests less regulatory risk." Reuters.

⁷¹ Myra P. Saefong. 2020. "Here's how the U.S. presidential election could shake up the oil market." Marketwatch.

⁷² Matthew Weaver. 2020. "Congressional elections could impact commodity prices most, expert says." *Capital Press*.

⁷³ Such as Snowberg, Zitzewitz, and Wolfers (2006); Zitzewitz and Wolfers (2016); and Jayachandran (2016).

Available at: <https://www.frbsf.org/economic-research/publications/working-papers/2006/08/>,

<https://www.brookings.edu/research/what-do-financial-markets-think-of-the-2016-election/>,

<https://escholarship.org/content/qt25p4z52g/qt25p4z52g.pdf?t=krmnet>.

⁷⁴ Public comment by Angelo Lisboa. Available at

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69666>.

⁷⁵ Ksenia Galouchko. 2020. "JPMorgan Says Biden Victory Could Mark a Stock Market Shift." Bloomberg.

Many other comment letters by retail traders (Raphael Crawford-Marks, Scott Supak, Jacob Colbert, Jacob Faircloth, Andrew Karas, Joseph Turano, among many others), industry leaders (Jorge Paulo Lemann, Christopher Hehmeyer, Ron Conway, Seth Weinstein, among many others) and owners of politically sensitive businesses, (Continental Grain Company, Klarna, Greenwork, Upsolve, among many others) agreed and specifically discussed personal hedging use cases.⁷⁶ Consider the comment by Scott Supak:

In the more immediate political future, the hedging benefits are obvious: since I'm no longer employed through my union, my wife no longer has health coverage through my union, so we must purchase (very expensive) health insurance from the marketplace. When it seems that Republicans are likely to take control, I can invest in that possibility, and hedge against the risk that her health insurance premiums will go up (or that the subsidy will get smaller, or that her ability to purchase insurance at all is taken away completely).⁷⁷

Or the comment by Greg Sirotek, the co-founder and CEO of Moneytree Power, a startup dedicated to installing solar power:

Congress has an incredible influence over the future of the zero-carbon energy industry, particularly the solar industry...Given the respective differences in the two parties' positions on the importance of climate change mitigation, renewable energy development and the deficit, the risk profiles depending on which party is in power is vast. An event contract which pays out on the basis of Congressional control would allow our business to manage this previously unhedged risk.⁷⁸

Lemann, a founder at 3G Capital (one of the world's largest investment firms) and a Board member of firms like AB-InBev and Kraft Heinz (some of the largest participants in traditional agricultural and metals futures), wrote:

These statements [the *Nadex Order's* claims that there are no hedging or price basing use cases for elections] are inconsistent with the preponderance of the academic research on the subject and is inconsistent with the actual experience of anyone who has ever operated a business in or with the United States or traded on the global commodity markets. Experience and empirical observation show that elections have consequences,

⁷⁶ Public comments 69668, 69715, 69667, 69683, 69678, 69619, 69684, 69717, 69714, 69718, 69727, 69707, 69677, 69655.

⁷⁷ Public comment by Scott Supak. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69715>

⁷⁸ Public comment by Greg Sirotek. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70751>.

and these consequences directly create risk that can be hedged, and are factored into pricing commodities, financial assets, and services.⁷⁹

Hehmeyer, former Chair of the National Futures Association and Board Member of the Futures Industry Association, added that many are affected *regardless of policy outcomes*:

For example, media personalities and companies face risk from Congressional control and elections. Early professionals hoping to work on Capitol Hill know there are far more positions available if their preferred party is victorious, as there are more Congressional offices and committee positions for them to staff. A consultancy that specializes in specific topic areas (for example, a green energy consultancy) may know the demand for their services will decline in anticipation that their issue of expertise is less likely to be operative under a split Congress. These risks occur regardless of the legislation that actually passes. There are billions of dollars at risk surrounding the outcome of Congressional control and elections. These risks can reasonably be expected to be managed through this contract on Congressional control.⁸⁰

Although some commenters claimed election outcomes aren't predictable enough to be a useful hedge, that in no way contradicts or even diminishes those who say the opposite. *At most*, those commenters don't see hedging utility for themselves. But they cannot credibly say, especially given the comment file, that all the people who identify how they would use the contracts for hedging and managing their risk are mistaken or deficient in their ability to recognize risk and potential tools to manage or mitigate that risk. It would be arbitrary for the Commission to listen only to those who assert that there is no hedging use case for anyone when there are many others who state that they *would* use the product for themselves or their business.

As noted by Hehmeyer, there is sufficient impact from elections themselves, independent of the policy implications of political control, to not only justify these markets' economic utility but to make them valuable. In addition, markets already believe that the policy implications of elections themselves are sufficiently meaningful so as to be worth repricing assets, suggesting that they are predictable *enough*. Elections have vast consequences, which directly impact the likelihood of events happening or not happening (such as a bill being passed). While it is true that there is some uncertainty about the precise implementation of any given law by a new Congress (e.g., what exactly would the size of the stimulus checks be, what exactly would the new tax rate be), changes in probabilities are more than sufficient for hedging purposes. In addition, once the specifics of a policy risk have been announced (like the text of a bill), it's practically impossible to hedge because of the high cost now that the probability of the event has increased. It's

⁷⁹ Public comment by Jorge Paulo Lemann. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69684>.

⁸⁰ Public comment by Christopher Hehmeyer. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69717&SearchText=christopher>.

important for a potential hedger to hedge in advance of the specifics of their risks being announced.

Changes in *general risk* also can provide a strong hedging need as opposed to the changes in risk of a specific outcome. If one party is in complete control of Congress, there is likely to be a change in *general risk* on carbon-based energy products and industries and an opposite change in *general risk* on renewable energy products and industries. While the specific policies implemented may be hard to know in advance, that change in *general risk* has been discussed at length in comment letters and is hedged extensively by larger institutions through complex products.⁸¹

Consider a concrete example of probabilistic change from the bond markets. Ten percent of the catastrophe bond market is in “parametric triggers,” which means the bond pays out if certain meteorological triggers are met. The bond issuer does not know for certain whether the storm that meets the threshold will cause mass flooding, power outages and property damage (and conversely, it’s possible that such damages could occur with a storm that does not meet the trigger thresholds) yet they use the bond to hedge nonetheless, because other features of the bond (hedging wind speed, namely) are more important to them than eliminating basis risk. Moreover, even if a wheat farmer buys a contract that pays out if the price of wheat falls below a certain threshold, there is still some uncertainty as to whether that event will harm them. It’s possible that (a) wheat falls below a certain threshold because weather conditions are so great that there was a bumper crop and that the increase in their supply offset the loss in price, or (b) that the national price does not perfectly correlate with the local price they received—but they can use the product nevertheless.

11. Should the Commission consider contract and position sizes, size of trade requirements, and/or an exchange’s intended customer base to help assess whether a contract is likely to be used for hedging in at least some cases? Does the requirement that all contracts listed on Kalshi must be fully-collateralized affect this analysis? Does the requirement that these contracts trade in multiples of 5000 and/or the position limits applicable to the contracts affect the analysis of the hedging utility of the contracts?

As noted earlier, outside of the public interest test, it is well settled that there is no required hedging test of the Contract, nor one provided by Congress, the rules, or the regulations.⁸² Hedging should be an important consideration as part of a contract’s public interest test should the Commission find that it involves one of the enumerated activities of the Special Rule, though

⁸¹ Public comment by Angelo Lisboa. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69666>.

⁸² Even in the public interest test, the Exchange notes that it is not at all settled that the original “economic purpose test” was resurrected. The better reading is that Congress wanted the Commission to look at the variety of factors that are discussed in the CEA, its purpose, and the core principles.

it need not be the only consideration. Hedging is in the public interest and promoting risk mitigation is a core mission of the CFTC and Kalshi.

In addition, whatever standard the Commission uses, Kalshi's contracts are permissible. As evidenced by the public comments, the intended customer base is a mixture of hedgers, liquidity providers/market makers, forecasters, and speculators. This is consistent with the customer base of some of the world's largest commodity markets, and is thus wholly permissible. The Commission would be speculating to suggest otherwise given the large body of relevant evidence.

1: Should the Commission consider contract and position sizes, size of trade requirements, and/or an exchange's intended customer base to help assess whether a contract is likely to be used for hedging in at least some cases?

The Commission can consider factors beyond hedging utility in its public interest analysis, should it find that the contracts involve one of the enumerated activities of the Special Rule. However, it should not consider an exchange's intended customer base. This would be very speculative. Customer bases change over time. In many cases, an Exchange may use a product in order to attract a new customer base, so using past customers as the foundation for guessing what the "intended customer base" is would be erroneous. If anything, this test would inappropriately penalize any novel product, as those are the products most likely to have an intended customer base most different from the existing user base. In short, there is no basis in law for the Commission to speculate about whether an Exchange's "intended customer base" meets its standards.

Trade requirement sizes are also not relevant. It may affect the number of parties who use the contract, for what purpose, and in what capacity; but nonetheless, the contract cannot serve *less* of a hedging function because of the proposed trade size, which is neither exceptionally small nor large compared to derivatives products available on CFTC-regulated boards of trade.

2: Does the requirement that all contracts listed on Kalshi must be fully-collateralized affect this analysis?

Whether a contract is fully collateralized or margined should not influence the Commission's thinking. Further, in this case it would be irrelevant. The hedging use cases shown by the public comments and other evidence provided to the Commission by Kalshi show that there is no basis to conclude that full collateralization will deter or preclude hedging behavior. Individuals, small businesses, and medium-sized businesses are all interested in using the contracts as they stand and as Kalshi proposed. Accordingly, even if the Commission considered the full collateralization requirement, it would still easily pass the test.

There is one area where the full collateralization requirement becomes relevant and that is in regard to responsible innovation. As a foray into quasi-new territory, it makes sense that the Exchange has certified only a fully collateralized product. This requirement will prevent excessive leveraging, and while it certainly may be appropriate to have margin products on this in the future, as an initial product it is prudent and sensible to maintain Kalshi's requirement that the contract be fully collateralized. Indeed, Kalshi should be commended for its cautious approach to innovation.

3: Does the requirement that these contracts trade in multiples of 5000 and/or the position limits applicable to the contracts affect the analysis of the hedging utility of the contracts?

No. As discussed earlier, trade requirement sizes are not relevant. It may affect the number of parties who use the contract, for what purpose, and in what capacity; but nonetheless, the contract cannot serve *less* of a hedging function because of the proposed trade size, which is neither exceptionally small nor large compared to derivatives products available on CFTC-regulated boards of trade.

12. Should the Commission consider the contract design and payout to help assess the hedging utility of the contract? For example, are binary contracts useful for hedging nonbinary economic events?

1: Should the Commission consider the contract design and payout when trying to assess the economic utility of the contract?

As noted in previous responses, outside of the public interest test, there is no required hedging test of the Contract, nor one provided by Congress, the rules, or the regulations. Hedging may be an important consideration as part of a contract's public interest test should the Commission find that it involves one of the enumerated activities of the Special Rule, though it need not be its only consideration as part of that test. Hedging is in the public interest and promoting risk mitigation is a core mission of the CFTC.

In addition, as argued above, the Commission should not speculate about the exact amount or percentage of total trading that will be used to hedge. Instead, it should consider whether there are hedging use cases. It is not contrary to the public interest for the contracts to be utilized for hedging as often as the market sees fit to hedge—many contracts listed by other exchanges are traded very little at all.

In fact, it is in the public's interest for *the market* to determine whether or not a contract design is appropriate for hedging, not the Commission. If the contract design is a poor fit for hedging

needs—which it does not appear to be, especially given the many public comments by retail, small businesses, and industry in support—then Kalshi will attract fewer participants and in the future will amend the contract structure to improve. The incentives of the Exchange and hedgers are aligned. Substituting the Commission’s judgment for the market’s would short-circuit that valuable process. Accordingly, the Commission’s inquiry into hedging as part of its public interest inquiry should be whether the contracts can be used for hedging. As noted, however, the contracts here have significant hedging utility that would pass any of these tests.

Moreover, different firms have different hedging needs, and different structures can best meet those needs. What works for one firm may not work best for another firm. As a result, the Commission should not attempt to speculate about whether a particular structure would work, as they may miss many firms for whom an alternative structure is better. The utility of the market is that there exists a profit incentive to create products for even niche groups of buyers, and insofar as private firms are far closer to their potential customer base than a government agency which does not interact with them on a daily basis (unlike an exchange), it would be highly inappropriate for the Commission to impose its judgment about whether a product’s structure meets potential customer’s needs. It’s in the public interest to permit innovative contracts that they may use.

2: Are binary contracts useful for hedging nonbinary economic events?

On a superficial level, Congressional control is one of the most true “binary” events in the world: either the Republicans win or the Democrats win. While the margin in each chamber certainly matters (a 53-Democrat Senate does look different from a 50-Democrat Senate), there is a sharp, binary, discontinuity in economic effects when control tips from one party to another.

Perhaps the Commission might argue that while Congressional control is binary, the effects of Congressional control are non-binary. Some people (like energy firms) might be affected a lot, whereas other people (like an IT consultancy) might be affected relatively less. Then there exists a continuum between the energy firm and the IT consultant of people affected. However, it does not follow that binary events cannot be a suitable tool for hedging since the effects are still caused by the binary control.

But more importantly, binary products are still capable of hedging non-binary events. The Commission has allowed binaries on the federal funds rate on the Chicago Board of Trade, even though it is self-evidently true that some people are hurt (or helped) by changes in interest rates more than others.⁸³ The Commission has allowed event binaries on monthly inflation prints, even though the Consumer Price Index is a continuous distribution of real numbers. Hundreds of millions of dollars are traded annually on binary parametric trigger catastrophe bonds, even

⁸³ Hunt, Katherine. “CBOT to launch binary options on target federal funds rate.” *MarketWatch*. 2006.

though the economic effects of such catastrophes are far from binary. And traders hedge probabilities, not absolutes. Accordingly, binary products are perfectly compatible as a hedging device with non-binary economic events.

13. Do the contracts serve a price-basing function? For example, could they form the basis of pricing a commercial transaction in a physical commodity, financial asset, or service?

Yes. As discussed earlier, the market frequently reprices assets on the basis of changes in election expectations and election outcomes.⁸⁴⁸⁵⁸⁶ Evidence abounds from the market, the financial press, and academia.

In 2012, more than two dozen economists signed a letter to the Commission supporting Nadex's submission that argued as much. Led by the late Nobel Laureate Kenneth Arrow in that 2012 letter, they wrote:

Political event futures facilitate price discovery in other asset markets. One of the findings of [our] research is that firms and industries are exposed to political and policy risk. Political event futures provide investors with a market-based assessment of outcome probabilities, which reduces investors' uncertainty when trading other assets.⁸⁷

Many economists have done the same for Kalshi, including Nobel Laureate Robert J. Shiller, Phillip Tetlock, Justin Wolfers, Scott Sumner, Michael Abramowicz, Joseph Grundfest, Alex Tabarrok, Michael Gibbs, Jason Furman, David Pennock, Harry Crane, David Rothschild, Koleman Strumpf, Ryan Oprea, and others.⁸⁸ A letter signed by Pennock, Crane, Rothschild, and Strumpf argued,

Prediction market prices in political and policy events would help facilitate price discovery in a wide-range of asset markets, affecting the entire economy (note that pricing is freely available to non-traders). Political and policy events matter: they expose a wide-variety of businesses to risk that traditional financial markets have trouble pricing. A robust set of markets for political and policy events could price that risk, and, if they were allowed to flourish, could eventually grow to provide hedges where uncertainty is particularly acute.⁸⁹

⁸⁴ Noel Randewich. 2020. "S&P 500 futures rise as U.S. election suggests less regulatory risk." Reuters.

⁸⁵ Myra P. Saefong. 2020. "Here's how the U.S. presidential election could shake up the oil market." Marketwatch.

⁸⁶ Matthew Weaver. 2020. "Congressional elections could impact commodity prices most, expert says." *Capital Press*.

⁸⁷ *Nadex* public comment by Zitzewitz et al. Available at <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/ericzitzewitzltr020312.pdf>.

⁸⁸ See public comments 70761, 69708, and 69735.

⁸⁹ Public comment by David Rothschild. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69735>.

The contracts can obviously be used to price MIAx's corporate tax futures and Kalshi's other political event markets related to bills passing, government shutdowns, and the debt ceiling. They can also be used to price other non-products, and election probabilities frequently are, as discussed above and in Kalshi's submission. For example, they can be used to help price economic event contracts. Investment banks provide clients and the public with recommendations on how Congressional outcomes affect macroeconomic forecasts. For example, Morgan Stanley cited the chance of stimulus along with infrastructure spending and corporate tax changes as a vehicle for a "blue wave" leading to a weaker dollar, lower interest rates, stronger GDP growth and lower bond prices.⁹⁰⁹¹ The Exchange provided many specific use cases and pricing analysis in its original submission.

Many also stated as much in public comments, including Flip Idiot, Victor Jacobsson, Angelo Lisboa, Peter Kempthorne, Seth Weinstein, David Pollard, David Trinh, Eriz Zitzewitz, James Cust, Caesar Tabet, Reed Newell, Jorge Paulo Lemann, Sebastian Strauss, Christopher Hehmeyer, Ron Conway, and Margaret Stumpp. As Stumpp, a senior vice president at Prudential Financial and a co-founder of Quantitative Management Associates, wrote,

...a well functioning market for contingent political outcomes should improve the prices at which other securities (eg, stocks, bonds, options, etc...) trade. This reduces uncertainty, enhances capital market liquidity, and improves the efficiency by lowering uncertainty.⁹²

Consider the following example: a junior investment bank has been instructed to price a security. That price is reflective of the stocks' net present value, itself a reflection of future expected profits. This includes political risk. If that banker knew with certainty that Republicans will take control of Congress, for example, and corporate taxes will not be raised, she would price the security higher than otherwise. Kalshi's contracts would help her in doing so.

14. Are the contracts contrary to the public interest? Why or why not?

No.

1: The contracts have a strong economic purpose.

The hedging and price basing use cases are myriad and would allow individuals to take advantage of a product that is currently strongly in demand. Elections cause extremely large

⁹⁰ Morgan Stanley. 2020. "A Revised Guide to Economic Policy Paths & Market Impacts".

⁹¹ Morgan Stanley. 2020. "2020 US Election Preview: 5 Themes to Watch for Investors."

⁹² Public comment by Margaret Stumpp. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69722>.

economic impacts and are some of the biggest risks that many businesses will ever face. This is detailed at great length in Kalshi's submission and has been validated by dozens of public comments from retail, business, academia, and members of industry, including Kevin Standridge, Sam Altman, Geoff Ralston, Robert Orr, Valentin Perez, Robin Hanson, James Bailey, Rohan Palvulri, Jason Crwaford, Dustin Moskovitz, Andrew N, and James Angel.

2: The contracts would serve as useful tools for voters, the media, and the public that would fight disinformation, improve election integrity, and improve decision making including policy making

The demand for accurate information surrounding elections is enormous – and valuable. This is why so many Americans turn to election models and updates offered by *FiveThirtyEight*, *The New York Times*, and *The Economist* around election time for advanced models that incorporate information. Its markets are consistently referenced as informative and useful by major, credible news organizations like *CNN*, *CNBC*, *Politico*, *Bloomberg*, *The Economist*, *The Wall Street Journal*, *The Washington Post*, and *The New York Times*, across sections like *The Upshot*, *DealBook*, opinion columns, and the technology section. In addition, Predictit has repeatedly been cited by prominent political officials and thinkers. Examples include economists like Jason Furman, previously President Obama's Council of Economic Advisors Chair (who submitted a comment letter detailing election markets use while he was in the Administration); Nobel Laureate Paul Krugman, a Professor at The Graduate Center and a columnist for *The New York Times*; and data scientists/reporters like Nate Silver, founder and editor-in-chief of *FiveThirtyEight*.⁹³⁹⁴

In a public comment, Furman also emphasized the importance of election markets for policy making. As he wrote,

...in the White House I, along with other members of the economic team, would regularly refer to prediction markets on electoral outcomes and specific events to help inform our understanding of how political and economic developments would affect economic policymaking. In understanding the risks of a government shutdown or debt limit showdown, for example, it would be helpful to understand what informed traders with money at stake would expect—a method of understanding probabilities that research has consistently shown is superior to other ways of summarizing and updating based on information.⁹⁵

⁹³ For the sake of brevity, a full list of citations in this section can be found at the end of this document.

⁹⁴ Public comment letter by Jason Furman. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69708>.

⁹⁵ *Ibid*

Professor Furman went on to detail the other benefits for the contract, including helping academic researchers and educational benefits, a point also made by others, including Sebastian Strauss. PredictIt also has been used to promote civic engagement by undergraduates. Berg and Chambers (2016) found that using prediction markets, including PredictIt, increased user interest in civics and user news consumption.⁹⁶

The preponderance of the academic literature suggests that existing media has misaligned incentives when it comes to reporting on a given party's chances of political control. This often results in bad reporting. For example, University of Pennsylvania professor Philip Tetlock evaluated the statements made by pundits and found that 15 percent of predictions claimed to be "impossible" did indeed occur and 27 percent of predictions claimed to be a "sure thing" did not.⁹⁷

By providing an instant check against pundits, a market-based price created by the contracts can aid information aggregation for the public. For the numerically-inclined or the financially-minded, a viewer can see that one commentator is asserting that candidate X is a "sure thing" but the Kalshi contract gives them only (e.g.) a 20% chance of winning. They now have a competing alternative to that pundit's information.

Markets tend to be more accurate than any pundit or forecasting alternatives. The efficient, price-discovering nature of markets in a wide range of contexts is a well-substantiated finding in academic research. The collective wisdom of many people who have a direct monetary stake in the outcome results in a valuable price signal. Weather derivatives and agricultural futures are better at predicting the weather than meteorologists. Markets trading on the reproducibility of scientific research are better at discovering which papers will reproduce than experts, who do no better than chance. Most importantly, research studying IEM and PredictIt have confirmed that markets provide more accurate information than traditional forecasting methods.

Kalshi's contracts would provide a visible, well-trusted benchmark against which to evaluate a pundit's predictive power. As Professor Tetlock observed, "prudent consumers should become suspicious" when they confront a public record of poor performance relative to the market. In Tetlock's words, "Unadjusted ex ante forecasting performance tells consumers in the media, business, and government what most want to know: how good are these guys in telling us what will happen next?"⁹⁸

3: The contracts would not serve as threats to either election integrity or the perception thereof; instead, it would improve them both.

⁹⁶ Berg & Chambers. *Bet Out the Vote: Prediction Markets as a Tool to Promote Undergraduate Political Engagement*. 2018. Journal of Political Science Education.

⁹⁷ Philip Tetlock. "Expert Political Judgment". 2005.

⁹⁸ *Ibid*

Not threatening election integrity

It is important for the Commission to engage with the evidence on election integrity rather than speculate. The *Nadex Order's* suggestion that voters could be incentivized to switch their votes, and thus harm election integrity, was outright speculative in 2012, and has since been disproven by PredictIt's success without any claim of, let alone proof of, election impropriety driven by those markets. Today, election trading remains alive and well in other democracies like the United Kingdom, Australia, Ireland, and New Zealand⁹⁹, without documented attempts at—let alone successful—distortion of the electoral process. Several commenters confirmed this, including Eric Crampton, the academic advisor to iPredict, a New Zealand based political prediction market:

What experience we had with iPredict suggests CFTC really doesn't have anything substantial to worry about in allowing contracts on political events. If anything, they heightened voter engagement. The CE [Chief Executive] of iPredict even featured on the nightly news during the election, giving the latest on election market prices. And for that brief period, whenever blowhard partisans insisted that some outcome was going to happen, people could just point to the iPredict price on the event and ask them why they thought that price was wrong, and whether they'd actually put their money where their mouth was. It was a remarkable era. iPredict inflation forecasts (they also had markets on inflation going out several years - it was so very good) wound up being noted in our Reserve Bank's Monetary Policy Statements. I desperately miss it. I envy the opportunities Americans could have if CFTC takes a sensible approach to regulation.¹⁰⁰

Or Dustin Moskovitz, a co-founder of Facebook and founder of Asana:

Of course, it's important to validate that these contracts would not conflict with the public interest, and specifically the integrity of our elections. I am confident, however, they would not do so. Similar markets not only exist in many liberal democracies like the UK, but create a thriving scene that actually encourages voter participation and engagement.¹⁰¹

References to other political markets without integrity issues were made by many commenters, including, in addition to the above, Justin Xavier Geraghty, Upsolve founder Rohan Pavuluri, People's Policy Project founder Matt Bruenig, Zvi Mowshowitz, Roots of Progress founder

⁹⁹ iPredict, the New Zealand political trading exchange, is no longer in operation, but was following the *Nadex Order*.

¹⁰⁰ Public comment by Eric Crampton. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69738>.

¹⁰¹ Public comment by Dustin Moskovitz. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69716>.

Jason Crawford, macro analyst Sebastian Strauss, Quantitative Management Associates co-founder Margaret Stumpp, and New York University Law School professor Max Raskin, among others.

The economic impacts of elections themselves dwarf the value of Kalshi's contracts many, many times over. Likely trillions in stock value are deeply dependent on elections; entire sectors, firms, and places can be favored by a candidate for office; and almost every actor in the economy is directly affected by tax rates. Elections already have billions in consequences for retail, small businesses, and industry, dwarfing the value of any Kalshi contract, and yet attempts at manipulation are unlikely, and successful manipulation even more so, thanks to the large, decentralized nature of elections, strong political norms, and laws protecting the vote. These contracts do not change, much less materially change the fact that individuals already have large stakes in election outcomes.

The only groups that can directly affect the leadership decisions are the U.S. Senate and U.S. House of Representatives. Members of these groups are extremely unlikely to attempt intentional manipulation of the leadership of their chambers merely to settle the contracts a certain way. Their finances are heavily monitored and subject to public disclosure and scrutiny, and Kalshi does not permit them, their close associates, or families to trade. Kalshi flags them and other politically exposed persons in the Know-Your-Customer authorization. Members of Congress also have a sworn duty to represent their constituents and have strong incentives not to manipulate electoral processes for private gain. Other related officials (like election officials, vote counters) also take such oaths and are heavily monitored because of the strong public interest in maintaining election integrity. This should clarify any claim that this could de-legitimize elections internal to Congress itself.

As further evidence, consider the history of political control contracts. University of Michigan professor Paul Rhode and Wake Forest professor Koleman Strumpf conducted a systematic review of the history of prediction markets both domestically and abroad, documenting their emergence back to "16th century Italy, 18th century Britain and Ireland, 19th century Canada and 20th century Australia and Singapore."¹⁰²¹⁰³ In the United States, they were popular from the post-Civil War period until the Great Depression tarnished the image of Wall Street in the public imagination. They wrote,

Although vast sums of money were at stake, we are not aware of any evidence that the political process was seriously corrupted by the presence of a wagering market. This

¹⁰² Paul Rhode and Koleman Strumpf. 2012. "The Long History of Political Betting Markets: An International Perspective." Strumpf also was a signatory to a supportive public comment. See Public comment 69735. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69735&SearchText>

¹⁰³ Paul Rhode and Koleman Strumpf. 2003. "Historical Prediction Markets: Wagering on Presidential Elections".

analysis suggests many current concerns about the appropriateness of prediction markets are not well founded in the historical record.¹⁰⁴

Prices are not able to be manipulated to the give the false impression of momentum

One may also imagine that a coordinated group of individuals may conspire to manipulate market prices to give the false impression of candidate “momentum,” thus potentially harming the democratic process. This concern has been tested several times by researchers, who have concluded that all attempts at manipulation have failed.

Koleman and Strumpf in a later paper examined previous American political prediction markets and found that no previous effort at manipulation was capable of sustaining anything more than fleeting price movements. They wrote, “we find little evidence that political stock markets can be systematically manipulated beyond short time periods.”¹⁰⁵ Moreover, the markets examined were much smaller and thus even more prone to manipulation than a fully regulated, liquid market like a DCM. As a result, manipulation on Kalshi’s market is even less plausible. Indeed, as George Mason University professor Robin Hanson and University of California at Santa Barbara professor Ryan Oprea found, one major reason why political contracts are resistant to manipulation attempts is that any attempt to manipulate prices induces informed counter-parties to enter on the other side of the market.¹⁰⁶ In fact, the greater the attempts to jack up one side’s prices, the greater the returns to becoming an informed trader. As University of Michigan economist Justin Wolfers and Dartmouth economist Eric Zitzewitz wrote regarding previous political contracts, “none of these attempts at manipulation had a discernible effect on prices, except during a short transition phase.”¹⁰⁷ This finding was also supported by over two dozen economists in their 2012 Nadex letter and by many letters supporting Kalshi’s submission.¹⁰⁸¹⁰⁹

Importantly, the fact that these contracts are already traded on Commission-sanctioned unregistered trading venues in the United States by Americans should demonstrate that they do not cause manipulation and that the markets are safe. In 2014, PredictIt, a new unregistered trading venue dedicated to election and political event contracts, received a no-action letter.

¹⁰⁴ Paul Rhode and Coleman Strumpf. 2003. “Historical Prediction Markets: Wagering on Presidential Elections”.

¹⁰⁵ Paul Rhode and Koleman Strumpf. 2005. “Manipulating Political Stock Markets: A Field Experiment and a Century of Observational Data.”

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¹⁰⁷ Justin Wolfers and Eric Zitzewitz. 2006. “Prediction Markets in Theory and Practice”.

¹⁰⁸ *Nadex* public comment by Zitzewitz et al. Available at <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/ericzitzewitzltr020312.pdf>.

¹⁰⁹ For example, the public comment by David Rothschild and company. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69735&SearchText=>.

Since then, it has hosted more than \$1B in contracts traded and has more than a quarter of a million registered users.¹¹⁰

This information – that hundreds of millions of dollars can be traded on political control contracts without triggering manipulation – was not available to the Commission the last time it considered similar event contracts in 2012. Although another political contract trading venue, the Iowa Electronics Market, received a no action letter in 1992, IEM is smaller and harder to access by individuals not associated with the University of Iowa. Now, far more money is known to have been traded on election outcomes.

The contracts would combat illegal behavior, improving the perception of election integrity

Americans readily access offshore platforms using a virtual private network such as Betfair.¹¹¹ Betfair had more than \$500 million traded on the 2020 election.¹¹² These platforms are not registered with the Commission as DCMs, but frequently host such markets. There are no indications that the markets caused or induced an attempt to manipulate elections, let alone a successful manipulation. However, if the Commission is concerned that election markets could nevertheless create election integrity threats, it is imperative to shift trading to an exchange compliant with the Core Principles, with insider trading protections, surveillance, and KYC. In this way, among others, approving the contracts would improve, not harm, election integrity and the perception of it.

As part of the Exchange's KYC verification and monitoring system, the Exchange also cross-checks applicants against comprehensive databases. In particular, the Exchange will check whether any Members trading on these contracts are on databases of Politically Engaged Persons. The Exchange further cross checks applicants against databases of family members and close associates of Politically Engaged Persons. These checks help to further reduce the potential for trading violations and further increase the integrity of this Contract.

The contracts would promote the public perception in election integrity by providing an accurate and competing tool for election forecasting

As described in detail in the second part of this question's response, there is immense social value in accurate election forecasts. This will fight disinformation and promote truth with politics, increasing voter confidence and engagement.

¹¹⁰ LinkedIn profile of former PredictIt employee: "Oversaw company growth of nearly 400% - from roughly 50,000 registered users to more than 250,000 registered users, and over 1.2 billion shares traded on PredictIt's market exchange." <https://www.linkedin.com/in/will-jennings-pi/>

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¹¹² See end of document.

Decreasing Partisanship

Studies consistently show that polarization and partisanship has increased dramatically in the last few decades: every year, greater numbers of people say they believe people from the opposite party are “immoral” and express other hostile sentiments. More concerning than mere hostility is how partisan antipathy can create alternative sets of facts--voters from different parties simply believe two sets of facts about the world. It is from this miasma where conspiracy theories about stolen elections emerge that damage the electoral process.

Prediction markets can help remedy this problem. Economists John Bullock, Alan Gerber, Seth Hill, Gregory Huber conducted an experiment in 2013 and found that partisan gap in beliefs (e.g. if Republicans believe a statement is true with probability 80%, and Democrats believe it with probability 35%, then the partisan gap is 45 percentage points) shrunk by a shocking 55 percent when participants were given a financial incentive for being right.¹¹³ If they were given a lesser financial prize for answering “unsure” (versus none for being wrong and a greater amount for getting it correct), the gap shrunk by about 80 percent.

The reasoning roughly tracks as follows: when no money is at stake, people conflate their beliefs as preferences. For example, a highly partisan liberal may say that a Democratic Party candidate is definitely going to win the 2024 presidential elections this year (a belief), when in reality they merely want the Democrat to win the championship (a preference). However, that same individual when challenged to trade money on that “definite” prediction will re-evaluate and calculate the odds and decide whether or not they should take that trade. In short, when no money is at stake, people express beliefs as mere signaling, lending itself to heavy partisan bias. When money is at stake, they are able to differentiate their beliefs from their preferences. In other words, the partisan reality gap shrinks, and individuals who trade on election markets become more attune to facts and less to partisan groupthink.

In conclusion, the contracts are not contrary to the public interest; rather, it strongly supports the public interest, as demonstrated by the evidence above. The contracts will improve asset pricing, provide risk management opportunities, enhance election integrity and trust, and shift trading activity to regulated exchanges.

15. Could the trading of these or other political control or election-based contracts affect the integrity of elections or elections within a chamber of Congress? Could they affect the perception of the integrity of elections or elections within a chamber of Congress?

¹¹³ John Bullock, Alan Gerber, Seth Hill, Gregory Huber. 2013. “Partisan Bias in Factual Beliefs about Politics.”

No. The benefits that Kalshi's contracts will have on the electoral and political process, as well as reasons why it will not have a negative effect, are also discussed in the prior question's response. Many of those same arguments are repeated here for ease and clarity, organized to suit this question.

1: The contracts will not harm election integrity or the perception of election integrity

It is important for the Commission to engage with the evidence on election integrity rather than speculate. The *Nadex Order's* suggestion that voters could be incentivized to switch their votes, and thus harm election integrity, was outright speculative in 2012, and has since been disproven by PredictIt's success without any claim of, let alone proof of, election impropriety driven by those markets. Today, election trading remains alive and well in other democracies like the United Kingdom, Australia, Ireland, and New Zealand¹¹⁴, without documented attempts at—let alone successful—distortion of the electoral process. Several commenters confirmed this, including Eric Crampton, the academic advisor to iPredict, a New Zealand based political prediction market:

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References to other political markets without integrity issues were made by many commenters, including, in addition to the above, Justin Xavier Geraghty, Upsolve founder Rohan Pavuluri, People's Policy Project founder Matt Bruenig, Zvi Mowshowitz, Roots of Progress founder Jason Crawford, macro analyst Sebastian Strauss, Quantitative Management Associates co-founder Margaret Stumpp, and New York University Law School professor Max Raskin, among others.

The economic impacts of elections themselves dwarf the value of Kalshi's contracts many, many times over. Likely trillions in stock value are deeply dependent on elections; entire sectors, firms, and places can be favored by a candidate for office; and almost every actor in the economy is directly affected by tax rates. Elections already have billions in consequences for retail, small businesses, and industry, dwarfing the value of any Kalshi contract, and yet attempts at manipulation are unlikely, and successful manipulation even more so, thanks to the large, decentralized nature of elections, strong political norms, and laws protecting the vote. These contracts do not change, much less materially change the fact that individuals already have large stakes in election outcomes.

The only groups that can directly affect the leadership decisions are the U.S. Senate and U.S. House of Representatives. Members of these groups are extremely unlikely to attempt intentional manipulation of the leadership of their chambers merely to settle the contracts a certain way. Their finances are heavily monitored and subject to public disclosure and scrutiny, and Kalshi does not permit them, their close associates, or families to trade. Kalshi flags them and other politically exposed persons in the Know-Your-Customer authorization. Members of Congress also have a sworn duty to represent their constituents and have strong incentives not to manipulate electoral processes for private gain. Other related officials (like election officials, vote counters) also take such oaths and are heavily monitored because of the strong public interest in maintaining election integrity. This should clarify any claim that this could de-legitimize elections internal to Congress itself.

As further evidence, consider the history of political control contracts. University of Michigan professor Paul Rhode and Wake Forest professor Koleman Strumpf conducted a systematic review of the history of prediction markets both domestically and abroad, documenting their emergence back to "16th century Italy, 18th century Britain and Ireland, 19th century Canada and 20th century Australia and Singapore."¹¹⁷¹¹⁸ In the United States, they were popular from the

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post-Civil War period until the Great Depression tarnished the image of Wall Street in the public imagination.. They wrote,

Although vast sums of money were at stake, we are not aware of any evidence that the political process was seriously corrupted by the presence of a wagering market. This analysis suggests many current concerns about the appropriateness of prediction markets are not well founded in the historical record.¹¹⁹

One may also imagine that a coordinated group of individuals may conspire to manipulate market prices to give the false impression of candidate “momentum,” thus potentially harming the democratic process. This concern has been tested several times by researchers, who have concluded that all attempts at manipulation have failed.

Koleman and Strumpf in a later paper examined previous American political prediction markets and found that no previous effort at manipulation was capable of sustaining anything more than fleeting price movements. They wrote, “we find little evidence that political stock markets can be systematically manipulated beyond short time periods.”¹²⁰ Moreover, the markets examined were much smaller and thus even more prone to manipulation than a fully regulated, liquid market like a DCM. As a result, manipulation on Kalshi’s market is even less plausible. Indeed, as George Mason University professor Robin Hanson and University of California at Santa Barbara professor Ryan Oprea found, one major reason why political contracts are resistant to manipulation attempts is that any attempt to manipulate prices induces informed counter-parties to enter on the other side of the market.¹²¹ In fact, the greater the attempts to jack up one side’s prices, the greater the returns to becoming an informed trader. As University of Michigan economist Justin Wolfers and Dartmouth economist Eric Zitzewitz wrote regarding previous political contracts, “none of these attempts at manipulation had a discernible effect on prices, except during a short transition phase.”¹²² This finding was also supported by over two dozen economists in their 2012 Nadex letter and by many letters supporting Kalshi’s submission.¹²³¹²⁴

Importantly, the fact that these contracts are already traded on Commission-sanctioned unregistered trading venues in the United States by Americans should demonstrate that they do not cause manipulation and that the markets are safe. In 2014, PredictIt, a new unregistered

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trading venue dedicated to election and political event contracts, received a no-action letter. Since then, it has hosted more than \$1B in contracts traded and has more than a quarter of a million registered users.¹²⁵

This information – that hundreds of millions of dollars can be traded on political control contracts without triggering manipulation – was not available to the Commission the last time it considered similar event contracts in 2012. Although another political contract trading venue, the Iowa Electronics Market, received a no action letter in 1992, IEM is smaller and harder to access by individuals not associated with the University of Iowa. Now, far more money is known to have been traded on election outcomes.

2: It would improve election integrity and the perception of election integrity.

It would also improve election integrity, and the perception thereof, by providing a useful tool for voters, the media, and the public that would fight disinformation and improve election integrity.

Shifting trading to a regulate house

Americans can also readily access offshore platforms using a virtual private network such as Betfair.¹²⁶ Betfair had more than \$500 million traded on the 2020 election.¹²⁷ These platforms are not registered with the Commission as DCMs, but frequently host such markets. There are no indications that the markets caused or induced an attempt to manipulate elections, let alone a successful manipulation. However, if the Commission is concerned that election markets could nevertheless create election integrity threats, it is imperative to shift trading to an exchange compliant with the Core Principles, with insider trading protections, surveillance, and KYC. In this way, among others, approving the contracts would improve, not harm, election integrity and the perception of it.

As part of the Exchange's KYC verification and monitoring system, the Exchange also cross-checks applicants against comprehensive databases. In particular, the Exchange will check whether any Members trading on these contracts are on databases of Politically Engaged Persons. The Exchange further cross checks applicants against databases of family members and close associates of Politically Engaged Persons. These checks help to further reduce the potential for trading violations and further increase the integrity of this Contract.

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¹²⁷ See end of document.

Disrupting Disinformation

The preponderance of the academic literature suggests that existing media information has grossly misaligned incentives when it comes to reporting on a candidate's chances. These misinformed incentives tend to come from three sources: first, pundits may want to hype up a preferred candidate's chances in order to flatter the sensibilities of their audience. Second, pundits may want to directly contradict a so-called "mainstream" line about a candidate winning in order to gin up controversy and draw more clicks or viewership. As a result, they may claim an underdog is actually the true favorite and, to further court controversy and viewership, claim that evidence to the contrary is a function of fraud and deception. Third, even when pundits attempt to be honest, viewers themselves may seek out information that confirms their own biases, thus rewarding a subset of relatively dishonest commentators with greater advertising revenue from the increased viewership or readership. In fact, we have empirical evidence of the dismal performance of media figures in the science of prediction. University of Pennsylvania professor Philip Tetlock decided to evaluate the statements made by pundits to see if they bore a relationship to reality--they did not. 15 percent of statements claimed to be "impossible" did indeed occur and 27 percent of statements claimed to be a "sure thing" did not.¹²⁸

How can transparent, regulated election prediction markets help to ameliorate this situation? By providing an instant check against the ability of pundits to assert specific outcomes are "likely" when in reality they are long-shots. For the numerically-inclined or the financially-minded, a viewer can see that one commentator is asserting that candidate X is a "sure thing" but the prediction markets give them only (e.g.) a 20% chance of winning, they now know to view that commentator with suspicion. Unless that individual gives compelling reasons why thousands of highly informed individuals with money at stake are all systematically wrong, a viewer can understand that the content they are receiving is ideologically motivated and adjust accordingly.

Markets tend to be more accurate than any pundit or forecasting alternatives. The efficient, price-discovering nature of markets in a wide range of contexts is an extremely well-substantiated finding in academic research. The collective wisdom of many people who have a direct monetary stake in the outcome results in an incredibly valuable price signal. Weather derivatives and agricultural futures are better at predicting the weather than meteorologists. Markets trading on the reproducibility of scientific research are much better at discovering which papers will reproduce than experts, who do no better than chance. Most importantly, research studying IEM and PredictIt have confirmed that election markets provide more accurate information than traditional methods.

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By creating a visible, well-trusted benchmark against which to evaluate a pundit's predictive power, Tetlock writes, "prudent consumers should become suspicious" when they confront a public record of poor performance relative to the market. In Tetlock's words, "Unadjusted ex ante forecasting performance tells consumers in the media, business, and government what most want to know: how good are these guys in telling us what will happen next?"¹²⁹

Considering how destructive the scourges of misinformation and fake news have become to our Republic--and how critical a role the media has played in amplifying that misinformation--the need for prediction markets as a potential check only grows. Indeed, we would contend that the benefit of election prediction markets on reducing misinformation is large.

Decreasing Partisanship

Studies consistently show that polarization and partisanship has increased dramatically in the last few decades: every year, greater numbers of people say they believe people from the opposite party are "immoral" and express other hostile sentiments. More concerning than mere hostility is how partisan antipathy can create alternative sets of facts--voters from different parties simply believe two sets of facts about the world. It is from this miasma where conspiracy theories about stolen elections emerge that damage the electoral process.

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¹²⁹ *Ibid*

¹³⁰ John Bullock, Alan Gerber, Seth Hill, Gregory Huber. 2013. "Partisan Bias in Factual Beliefs about Politics."

Empowering Researchers and Policymakers

One of the most exciting applications of election event contracts is their ability to provide powerful new causal inference tools to researchers and policymakers. Right now, estimating the effect of elections is rather difficult--one cannot merely compare economic outcomes during one presidential administration versus another because the underlying conditions have dramatically changed. Likewise, comparing forward-looking financial indicators before and after Election Day runs into several problems, including that many markets are closed overnight and that the market has already priced in some probability of the eventual victor winning.

Enter political control contracts. If Party X has a 80 percent chance of winning and then when they actually win on election night, a stock goes up 1%, we can say that the total effect of the election was 5 percentage point (if going from 80 to 100 is 1%, then going from 0 to 100 is roughly 5%). But it can get even stronger: since researchers would now have a time series of how the probabilities change over time, they can use other events like debates, prominent speeches and the revelation of major scandals to regress forward-looking financial variables on election outcomes in a way impossible without prediction markets.

These tools are far from hypotheticals. Economists Justin Wolfers and Eric Zitzewitz have already conducted several studies that used previous prediction markets (like the Iowa Electronic Exchange) to discern the effects of political outcomes on economic variables.¹³¹¹³² However, the lack of liquidity on their underlying markets makes their studies relatively under-powered. Having a transparent, regulated exchange with greater liquidity could dramatically expand the universe of questions researchers could answer with this data.

Beyond researchers, a transparent, regulated exchange would create a large incentive for traders to develop sophisticated and accurate models about election outcomes in order to gain an edge. The 2016 and 2020 elections were famous for the failure of (most) published models, often attributed to systematic non-response bias in polls. A liquid prediction market would create an incentive for trading firms to develop solutions to these hard issues in order to make more money. Fortunately, there are substantial positive externalities to these investments: learning how better to model, poll and understand the population would help policymakers better understand their constituents so they can figure out what they actually want. Voting is a noisy signal of preferences--the financial incentive to create models to discern voter intentions could thus make our democracy even more responsive.

¹³¹ Erik Snowberg, Justin Wolfers and Eric Zitzewitz. "Partisan Impact on the Economy". *Journal of Economic Perspectives*. 2004.

¹³² Erik Snowberg, Justin Wolfers and Eric Zitzewitz. "Party Influence in Congress and the Economy." 2006.

The demand for accurate information surrounding elections is enormous, and valuable. This is why so many Americans turn to election models and updates offered by *FiveThirtyEight*, *The New York Times*, and *The Economist* come election time for advanced models that incorporate information. On election night 2020, PredictIt's website crashed because of so much incoming traffic. Its markets being consistently referenced as informative and useful by major, credible news organizations like *CNN*, *CNBC*, *Politico*, *Bloomberg*, *The Economist*, *The Wall Street Journal*, *The Washington Post*, and *The New York Times*, across sections like *The Upshot*, *DealBook*, opinion columns, and the technology section. In addition, it has repeatedly been cited by prominent political officials and thinkers. Examples include economists like Jason Furman, previously President Obama's Council of Economic Advisors Chair (who submitted a comment letter detailing election markets use while he was in the Administration); Nobel Laureate Paul Krugman, a Professor at The Graduate Center and a columnist for *The New York Times*; and data scientists/reporters like Nate Silver, founder and editor-in-chief of FiveThirtyEight.¹³³¹³⁴

16. Could the contracts be used to influence perception of a political party or its candidates' likelihood of success? To this end, could the contracts be used to manipulate fundraising or voting?

No. This concern has been tested several times by researchers on far smaller markets (which would be more susceptible to manipulation than a large, liquid market hosted by a regulated DCM) who have concluded that all attempts at manipulation have failed. The Commission should be evidence-based in its decision, though this also makes sense in theory.

Koleman and Strumpf examined American political prediction markets and found that no previous effort at manipulation was capable of sustaining anything more than fleeting price movements. They wrote, "we find little evidence that political stock markets can be systematically manipulated beyond short time periods."¹³⁵ Moreover, the markets examined were much smaller and thus even more prone to manipulation than a fully regulated, liquid market like one offered by a Designated Contract Market. As a result, manipulation on Kalshi's market is even less plausible. Indeed, as George Mason University professor Robin Hanson and University of California at Santa Barbara professor Ryan Oprea found, one major reason why political contracts are resistant to manipulation attempts is that any attempt to manipulate prices induces informed counter-parties to enter on the other side of the market.¹³⁶ In fact, the greater the attempts to push up one side's prices, the greater the returns to becoming an informed trader. As University of Michigan economist Justin Wolfers and Dartmouth economist Eric Zitzewitz wrote

¹³³ For the sake of brevity, a full list of citations in this section can be found at the end of this document.

¹³⁴ Public comment letter 69708. Available at:

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69708>.

¹³⁵ Paul Rhode and Koleman Strumpf. 2005. "Manipulating Political Stock Markets: A Field Experiment and a Century of Observational Data."

¹³⁶ Robin Hanson and Ryan Oprea. 2008. "A Manipulator Can Aid Prediction Market Accuracy." *Economica*.

regarding previous political contracts, “none of these attempts at manipulation had a discernible effect on prices, except during a short transition phase.”¹³⁷ This finding was also supported by over two dozen economists in their 2012 Nadex letter and by many letters supporting Kalshi’s submission.¹³⁸¹³⁹

This information—that billions of dollars have been traded on contemporary political control contracts without triggering manipulation—was not available to the Commission the last time it considered similar event contracts in 2012. Although another political contract trading venue, the Iowa Electronics Market, received a no-action letter in 1992, IEM is smaller and harder to access by individuals not associated with the University of Iowa. Now, far more money is known to have been traded on election outcomes without any adverse consequences.

Almost all claims that this is a possible threat are unsubstantiated, though the letter provided by Dennis Kelleher of Better Markets does try to provide some evidence. Specifically, it argued:

The proposed event contract is readily susceptible to manipulation... In her 2009 Harvard Law Review article “Prediction Markets and Law: A Skeptical Account,” Professor Rebecca Haw Allensworth detailed how bad actors might manipulate prediction markets: ‘Prediction markets are vulnerable to manipulation... First, they could profit by artificially lowering the trading price temporarily and purchasing shares to be sold at a higher price when the market returns to ‘normal’. Second, they could try to affect the informational value of the market. For example, a candidate’s supporter could purchase his shares at an inflated value, raising the perceived odds that he would win the election, and (hopefully) getting more voters to jump on the putative bandwagon’.¹⁴⁰

There are several issues with this line of reasoning:

1. Critically, this is a misapplication of the cited research.
 - a. Allensworth only cites one incident of successful manipulation, on an online exchange called TradeSports, referencing the case study on the incident conducted by Paul W. Rhode & Koleman S. Strumpf’s, “Manipulating Political Stock Markets: A Field Experiment and a Century of Observational Data.” However, Rhode and Strumpf conclude the opposite of Allensworth/Better Markets: that even the attempt to manipulate TradeSports’ small, unregulated market only succeeded in changing prices briefly, and conclude, “In the cases studied here, the speculative attack initially moved prices, but these changes were quickly undone and prices returned close to their previous levels. We find little evidence that

¹³⁷ Justin Wolfers and Eric Zitzewitz. 2006. “Prediction Markets in Theory and Practice”.

¹³⁸ Nadex public comment by Zitzewitz et al. Available at <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/ericzitzewitzltr020312.pdf>.

¹³⁹ For example, the public comment by David Rothschild and company. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69735>.

¹⁴⁰ Public Comment by Dennis Kelleher. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70788>

- political stock markets can be systematically manipulated beyond short time periods.”
- b. The other study cited, by Deck et al., does find researchers successfully manipulate a small exchange of *their own creation, with made up assets, with a mere eight traders*. This clearly cannot be grounds to judge Kalshi’s proposed contracts.
2. The vast majority of research on this issue demonstrates how shockingly resilient such markets are to manipulation even in spite of no regulation. This is discussed at length also in Appendix G, which details how the Contract is in compliance with Core Principle 3.
 - a. Like Allenworth, Deck et al. acknowledge this.¹⁴¹ They wrote, “Wolfers and Zitsewitz (2004, p. 119) assert that ‘The profit motive has usually proven sufficient to ensure that attempts at manipulating these [prediction] markets were unsuccessful.’ Failed attempts at manipulating markets include political candidates betting on themselves (Wolfers and Leigh 2002) and bettors placing large wagers at horse races (Camerer 1998). Hansen, et al. (2004) did successfully manipulate election prediction markets, but the effects were short lived. In fact, Rhode and Strumph (2009, p. 37) provide an extensive discussion of attempts to manipulate political markets and conclude that ‘In almost every speculative attack, prices experienced measurable initial changes. However, these movements were quickly reversed and prices returned close to their previous levels.’” They go on to cite more experiments that showed resilience to manipulation, including that of Ryan Oprea and Robin Hanson, two supportive commenters.¹⁴² They do not find any research that shows any successful manipulation that is not short-lived.
 3. The research cited by Better Markets only focused on small-scale, generally illiquid, unregulated online prediction markets. A highly regulated market that can onboard institutional clients is even less likely to be a victim of a particular manipulator, as markets incentivize speculators to reverse any potential price impact a manipulator could have. Indeed, Hanson and Oprea found, one major reason why political contracts are resistant to manipulation attempts is that any attempt to manipulate prices induces informed counter-parties to enter on the other side of the market. In fact, the greater the attempts to jack up one side’s prices, the greater the returns to becoming an informed trader. As University of Michigan economist Justin Wolfers and Dartmouth economist Eric Zitzewitz wrote regarding previous political contracts, “none of these attempts at manipulation had a discernible effect on prices, except during a short transition phase.” This finding was also noted by over two dozen economists in their 2012 Nadex letter and by many letters supporting Kalshi’s submission.

¹⁴¹ Deck, C., Lin, S., & Porter, D. (2010). Affecting policy by manipulating prediction markets: Experimental evidence. ESI Working Paper 10-17.

¹⁴² Hanson, R. and Oprea, R. “A Manipulator Can Aid Prediction Market Accuracy,” *Economica*, 2009, 76, 304-314.

17. Could the contracts facilitate violations of, or otherwise undermine, federal campaign finance laws or regulations? For example, could the contracts make it easier to sidestep prohibitions governing coordination between candidate campaign committees and political action committees?

No. The concerns this question raises are completely unrelated to the contract's function or impact. It would not improve (or impact at all) the ability of PACs and campaigns to coordinate.

If the implication is that they could do so more easily by providing an accurate picture of the state of the race, then public polling would also help such parties sidestep federal law, a plainly untenable proposition.

As described earlier, it is not plausible for any actor to try and create 'momentum' for their party by buying up one side's shares. One may also imagine that a coordinated group of individuals may conspire to manipulate market prices to give the false impression of candidate "momentum", thus potentially harming the democratic process. This concern has been tested several times by researchers, with all attempts failing. Koleman and Strumpf in a later paper examined previous American political prediction markets and found that no previous effort at manipulation were capable of sustaining anything more than fleeting price movements. They wrote, "we find little evidence that political stock markets can be systematically manipulated beyond short time periods."¹⁴³ Moreover, the markets examined were much smaller and thus even more prone to manipulation than a fully regulated, liquid market like a DCM. As a result, the probability of manipulation is implausible. Indeed, as George Mason University professor Robin Hanson and University of California at Santa Barbara professor Ryan Oprea found in one paper, one major reason why political contracts are rather invulnerable to manipulation attempts is that any attempt to manipulate prices induces informed counter-parties to enter on the other side of the market.¹⁴⁴ In fact, the greater the attempts to increase one side's prices, the greater the returns to an informed trader. As University of Michigan economist Justin Wolfers and Dartmouth economist Eric Zitzewitz write regarding previous political contracts, "none of these attempts at manipulation had a discernible effect on prices, except during a short transition phase."¹⁴⁵ This finding was also supported by the 2012 Nadex letter by over two dozen economists in the field and many of the ones supporting Kalshi's submission.¹⁴⁶¹⁴⁷

¹⁴³ Paul Rhode and Koleman Strumpf. 2005. "Manipulating Political Stock Markets: A Field Experiment and a Century of Observational Data."

¹⁴⁴ Robin Hanson and Ryan Oprea. 2008. "A Manipulator Can Aid Prediction Market Accuracy." *Economica*.

¹⁴⁵ Justin Wolfers and Eric Zitzewitz. 2006. "Prediction Markets in Theory and Practice".

¹⁴⁶ Nadex public comment by Zitzewitz et al. Available at <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/ericzitzewitzltr020312.pdf>.

¹⁴⁷ For example, the public comment by David Rothschild and others. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69735&SearchText=>.

18. Do the contracts present any special considerations with respect to susceptibility to manipulation or surveillance requirements?

As discussed at length in other parts of this letter, Kalshi's contract is not readily susceptible to manipulation, and is outright less susceptible than other commodity futures contracts. Kalshi engages in extensive market surveillance and employs Know-Your-Customer authorization to prevent manipulation in compliance with the Core Principles. Accordingly, we believe the contemplated measures combined with Kalshi's robust market surveillance program and dedicated technology are appropriately calibrated to address the particular risks associated with these particular contracts. Kalshi's rules also prohibit trading on non-public material information.

As with other contracts that deal with publicly important information, such as on the monetary policy decisions of the Federal Reserve, the integrity of the decision-making process by the Federal Open Market Committee has not been eroded despite contracts that trade enormous volumes on their impact. This is no different.

For these contracts, Kalshi employs Know-Your-Customer authorization and would prevent trading by Politically Exposed Persons, including campaigns and PACs, as well as operator's close associates and family. It also has identified a long list of political actors who are specifically prohibited from trading.

Regarding informational advantages of market participants and private polling, a privately commissioned poll is not materially non-public information; any market actor can employ similar research strategies in many other markets. Every market has a discrepancy between its trading members' resources. For example, hedge funds have access to Bloomberg terminals that retail investors can't afford. Market participants have a financial incentive to gain access to better information; entire teams of meteorologists are hired to accurately predict agricultural futures prices. As then Commissioner Quintenz explained, "The goal of financial markets is not to protect or shelter the less informed. Rather, the market incentivizes being informed and executing on that knowledge. In other words, market efficiencies are earned - they are created through research, investment, and intellectual property."¹⁴⁸ This is a benefit of listing a market, not a harm; it results in more accurate pricing for the market, the benefits of which are discussed in detail in the questions regarding public interest.

Further, there are robust protections against manipulation. The Exchange has rules that prohibit manipulative trading, and the Exchange performs surveillance to detect manipulation. This serves as a deterrent to attempts to manipulate the market via manipulative trading. In addition, the Exchange's rules also prohibit trading on non-public information, and the Exchange performs

¹⁴⁸ See Statement of Commissioner Brian D. Quintenz on the Certification of ICE Futures U.S., Inc. Submission No. 19-119, May 15, 2019. Available at: <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement051519>

surveillance to detect violations of this rule. The Exchange is also adopting contract specific gating rules that further buttress this rule. Specifically:

- a. Before being allowed to participate, market participants must certify that they are not implicated by the prohibition list in Appendix B
- b. Before being allowed to participate, market participants must certify that they do not have access to material nonpublic information
- c. The Exchange's surveillance staff will conduct manual background checks and interviews with the top traders in a market, as well as randomly selected participants, to monitor and enforce the gating rules

The Exchange will be surveilling its market for any sign of trading that is indicative of manipulative or fraudulent behavior. The Commission will have all of the necessary data to do the same, should it so wish.

As discussed at length earlier in this response and in Kalshi's original filing, American elections are not readily susceptible to manipulation. In fact, manipulation of which party controls the U.S. Congress has never occurred. This is in contrast to existing markets that the CFTC regulates. Indeed, the CFTC has brought numerous enforcement actions against market participants who either manipulated or attempted to manipulate markets in oil, precious metals, cattle, and other commodity spot and futures markets. The Commission regularly brings almost a hundred enforcement actions per year and orders billions in monetary relief. Then, of course, there are digital asset markets, where the Commission has brought dozens of actions in an incredibly short time. Contrast that with elections, where election or voter fraud is extremely rare, and never succeeds at flipping the outcome of which party controls Congress. Even in cases where election manipulation has been attempted, it has only succeeded in affecting extremely small, local elections.¹⁴⁹

Any attempt to manipulate the contract would most certainly involve a high degree of speculation; the contract is in regard to the sum of hundreds of elections. It is not even possible to determine which elections will be the closest (and thus easiest to affect) in advance, even if some races are understood to be more close than others. As detailed in Appendix G, a large-scale conspiracy to coerce many individuals to vote a particular way across many different jurisdictions without being detected. A fraud of sufficient size would mean that this fraud is no *Ocean's 8*, or even *Ocean's 11*. You'd be looking at *Ocean's-well-into-the-hundreds-if-not-hundreds-of-thousands*. Manipulation of polling machines themselves is equally quixotic.¹⁵⁰ Taken all in all, it is very unlikely that a fraud pertaining to this contract will be attempted, and considerably less likely than in other areas that fall under the Commission's enforcement authority.

¹⁴⁹ <https://www.brennancenter.org/our-work/research-reports/truth-about-voter-fraud>

¹⁵⁰ <https://www.washingtonpost.com/politics/2022/11/01/truth-about-election-fraud-its-rare/>

Critically, there are already enormous stakes in U.S. elections, creating incentives for outcome manipulation; this contract will not change that fact. As discussed in extensive detail in Appendix C, in the public comments, and to anyone involved in industry, elections move prices and it is specious to presume that they do not. Wall Street firms and global finance all trade elections. The contract before the Commission is not novel in that regard; rather, it is a more efficient instrument than what firms currently use to take positions on elections.

19. What is the price forming information for these contracts while the contracts are trading? If the price forming information includes polling and other election prediction information, is that information regulated? How does the price forming information compare to informational sources (e.g. government issued crop forecasts, weather forecasts, federal government economic data, market derived supply and demand metrics for commodities, market-based interest rate curves, etc.) that are generally used for pricing commodity derivative products within the Commission's jurisdiction?

There is a plethora of information used by the public and market participants to help calculate the probability that a given party will take control of Congress. Some of these are regulated (e.g. federal government economic data) but some are not (e.g. polls). That being said, there is no requirement that such information be regulated, nor is it clear that regulated information is the primary source of pricing information for many commodity futures contracts compared to private market forecasts and data. As discussed at other points in this response, demand for accurate information on election probabilities is in incredibly high demand by the public, and as a result, there is a large, competitive market for such content.

With regard to whether polling would become regulated, the answer is not any more or any less than any of the other information that goes into pricing any commodity.

20. Should, and if so how would, the registered entity listing the contracts take steps to address possible manipulative and/or false reporting activity involving the price forming information for the contracts, while the contracts are trading?

The Exchange has already taken great steps to prevent and address manipulative behavior. As in some of the prior questions, it seems odd for the Commission to request *only* the public's input in this regard, but has not discussed this with Kalshi. Regardless, the Exchange has numerous safeguards in place to prevent manipulation.

Additionally, the Exchange notes that in particular, concerns regarding manipulating this contract are broadly unlikely. The market for credible information on elections and their probabilities is very competitive, and false information is equally as likely to impact Kalshi's market as reports regarding the production of oil do for oil futures. Should false information be reported, the

returns from being an informed trader who could sniff out so much information would grow commensurately.

That being said, the Exchange nonetheless is extremely focused on making sure that such concerns would not affect the market. For example, it has gated out polling organizations, and employees thereof, from trading. Kalshi engages in extensive market surveillance and employs Know-Your-Customer authorization to prevent manipulation in compliance with the Core Principles. The contemplated measures combined with Kalshi's robust market surveillance program and dedicated technology are appropriately calibrated to address the particular risks associated with these particular contracts. Kalshi's rules also prohibit trading on non-public material information.

As with other contracts that deal with publicly important information, such as on the monetary policy decisions of the Federal Reserve, the integrity of the decision-making process by the Federal Open Market Committee has not been eroded despite contracts that trade enormous volumes on their impact. This is no different.

It is also important to note what the correct legal standard is, which is not "free from attempted manipulation." Indeed, one need only to peruse the annals of the CFTC's enforcement actions to find many contracts that were manipulated (e.g. LIBOR) or the subject of an attempted manipulation. These event contracts, such as oil contracts, interest rate swaps, etc. are significantly more likely and susceptible to be manipulated than this contract. Indeed, the fact that a contract like this on a regulated market is so unlikely to be manipulated successfully is one of the reasons that the public is so keen on seeing the data from the market which will be far more reliable than many other data sources currently available.

21. Do Kalshi's limitations on market participation affect the susceptibility of the contracts and/or markets for the contracts to manipulation? Do the limitations affect the extent to which these markets could be used to influence perception of a political party or candidate or otherwise be implicated in attempted election manipulation? Are the limitations reasonably enforceable?

In practice, few to no parties have access to material insider information on the contract's outcome. Any potential information an actor could have is highly unlikely to be material regarding the outcome of—in total—several hundred Congressional races. It is important to keep in mind that the argument that Congressional Control can come down to the outcome of a handful of races, and some races can be decided by a margin of several thousand, hundred, or even individual votes, has little to no bearing on the contract's susceptibility to manipulation. The margin of victory before an election is unknown. If a nefarious actor attempted to manipulate the election in order to manipulate the contract, which is what the CFTC is asking in this question,

the actor would not know beforehand what the margin of victory would be. That nefarious actor would have to assess the size of the electorate, which is in every instance going to be large. Accordingly, it is hard to conceive of the definitive piece of material non-public information that will swing the outcome of the contract.

However, like all contracts on Kalshi, there is a prohibition to trade on material nonpublic information. This contract is no different in that regard. In response to various indications from the Commission, however, the Exchange adopted contract-specific rules for this contract to gate out certain people who would be more likely to have information that could be considered material nonpublic information. This gating itself is the proverbial “safeguard on a safeguard”.

As in other questions, Kalshi notes the incongruity of asking the public for input on how Kalshi will enforce a rule, without having asked Kalshi. Regardless, this rule is enforceable.

22. Should the Commission be responsible for surveilling, and enforcing against, possible manipulative and/or false reporting activity involving the price forming information for the contracts, while the contracts are trading?

It should be responsible for surveilling and enforcing against manipulative and false reporting activity while the contracts were live as much as it is responsible for doing so with other listed contracts, no more, no less.

Further, the Exchange notes that one of the benefits of having this activity on a regulated exchange is that the Commission will, for the first time, gain insight into the amount and level of activity of trading on congressional control. Currently, if, for example, Congress would invite the CFTC to the Hill and ask the CFTC to describe the current financial activity on congressional control, the CFTC will have nothing to say beyond there is activity, some on OTC, some on unregulated markets, some overseas. When pressed for details on who is participating, the CFTC will have to confess its utter ignorance. However, if the contract were to trade on regulated exchanges, the CFTC will not only know precisely what positions are being taken on the regulated markets, they will know who is taking them.

23. Could trading in the markets for the contracts obligate the Commission to investigate or otherwise become involved in the electoral process or political fundraising? If so, is this an appropriate role for the Commission?

There is no reason for the Commission to believe it will be responsible for policing attempts at, or successful, election fraud. No more and no less than the CFTC is responsible for any other type of underlying fraud that has impacts on a contract. Earlier this year, there were two individuals who were arrested for attempting to destroy power stations with the ultimate goal of

destroying the city of Baltimore.¹⁵¹ If successful, the sabotage would have impacted electricity prices significantly. Is the CFTC “obligated . . . to investigate or otherwise become involved in the” prosecution of these two individuals? Is the CFTC “obligated . . . to investigate or otherwise become involved in the” protecting of America’s power grid? OPEC+ impacts the prices of global oil, including the futures markets that the CFTC regulates. Is the CFTC therefore “obligated . . . to investigate or otherwise become involved in the” OPEC+ meetings? Is the CFTC “obligated . . . to investigate or otherwise become involved in the” determination of corporate dividends that underlie the CME’s contract? The answer to all of these is that the CFTC will get involved to the extent that it is necessary for it to administer and enforce the CEA. The CFTC does not, in any of these cases, assume the role of the “cop on the beat”. This application here is no different.

Election manipulation is a crime.¹⁵² There are law enforcement agencies who police elections, and elections are policed much more effectively than other markets that have CFTC derivative products trading on them. The Commission is not the only “cop on the beat” with regard to election fraud. Elections, unlike many other reference markets or events that have CFTC-derivatives trading on them, are governed by multiple law enforcement agencies whose very existence is to prevent and detect election manipulation and fraud. This includes the Federal Election Commission, the federal Department of Justice, state election commissions, state Secretaries of State, and state ethics commissions. History has shown that these agencies are very good at their job. The other day, the CFTC brought an enforcement charge against Alexander Mashinsky and Celsius Network, LLC, where the CFTC acknowledged the role that was played by both the SEC and the U.S. Attorney’s Office for the Southern District of New York.¹⁵³ Similarly, Cody Easterday committed fraud that was discovered by Tyson foods and prosecuted by the Department of Justice. The CFTC *also* charged Easterday, presumably after cooperating with the relevant criminal authorities. These are two examples of many. The CFTC is well-versed in cooperating with the relevant law enforcement agencies, be it the FBI or DOJ or any other relevant federal or state authority. There is no reason to assume that the CFTC would somehow lose that competency in this case.

24. What other factors should the Commission consider in determining whether these contracts are “contrary to the public interest?”

The Commission has never fully defined the full extent of the factors it considers under the public interest standard in Section 5c(c)(5)(C). Even the Nadex Order admits that the Commission can consider factors other than the economic purpose test. The Commission is not an expert in all areas, such as election law or integrity, voter confidence, or how to foster

¹⁵¹ <https://abc7chicago.com/power-grid-attack-sarah-clendaniel-brandon-russell-baltimore-plot/12777303/>.

¹⁵² <https://www.fbi.gov/how-we-can-help-you/safety-resources/scams-and-safety/common-scams-and-crimes/election-crimes-and-security#:~:text=Intentionally%20deceiving%20qualified%20voters%20to,%2Fhow%2Dto%2Dvote.>

¹⁵³ <https://www.cftc.gov/PressRoom/PressReleases/8749-23>

democracy, and the Commission should instead focus on what it knows: the value of a contract as a hedging interest and the value of a contract's price to market participants. As we noted in response earlier, these contracts are not contrary to the public interest because they have a large economic purpose, would serve as a useful tool for voters, the media, and the public that would fight information and improve election integrity. We note that the evidence supporting the contracts is wholly consistent with the stated findings and purpose of the CEA found in 7 USC 5. The contracts provide "a means for managing and assuming price risks, discovering prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities."¹⁵⁴ These contracts and their trading on Kalshi would "protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets."¹⁵⁵ Finally, allowing these contracts to trade on a CFTC-regulated DCM would "promote responsible innovation and fair competition among boards of trade, other markets and market participants."¹⁵⁶ In sum, these contracts are consistent with the CEA and its purposes and Kalshi has shown that they should be traded on a CFTC-regulated exchange with all of the protections that the CEA makes available to market participants.

The Commission should hold a contract is contrary to the public interest if it:

- Has no economic purpose
- Has no hedging utility;
- Has no price basing utility - meaning it has no effect on the prices of other commodities, assets, services, or commodity interests, which must therefore include *affecting the probabilities of* other events on which event contracts are now or in the future trading.
- *And* has no forecasting value to the public.

¹⁵⁴ 7 USC 5(a).

¹⁵⁵ 7 USC 5(b).

¹⁵⁶ *Ibid*

KalshiEX LLC

APPENDIX C (CONFIDENTIAL) – RISK MITIGATION AND PRICE BASING UTILITIES

The following sections will provide an explanation of the hedging utility of this contract.

- First, in section A, we will establish how firms generally make risk management decisions and how hedging fits into those decisions;
- Section B sets forth contract specific analysis, which will establish how political control contracts fit into the risk management framework described in section A. Section B also presents an analogy to climate risk hedging;
- Section C highlights the extensive evidence that demonstrates the impacts of elections are not merely hypothetical, but an actual phenomenon that presents tangible financial risk for firms;
- Section D presents several extensive illustrations of how the CONTROL contract will be used for hedging;
- Section E offers analogies to similar products;
- Section F explains how the Contract's specifications enhance its hedging utility for many market participants;
- Section G discusses the price basing utility of the contract; and
- Section H addresses miscellaneous comments that touch on the contract's hedging and price basing functions.

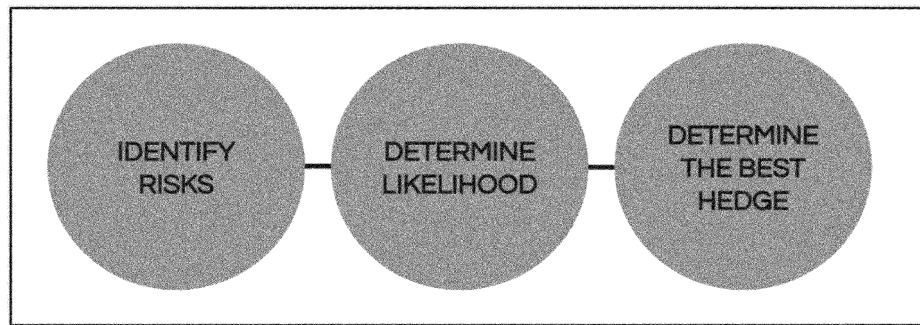
A. General risk management

Businesses face a panoply of potential harms that will affect and impact their value. These potential harms are risks. Risks include valuation risk (the value of the business's services or asset's decline), funding risk (access to credit or other funding declines), and operational risks (possible disruptions or errors in the production process that undermine their earnings), among many others. Each one of these general categories of risk will manifest and impact each business according to the business's unique activities, profile, composition, *et cetera*. In addition to these examples, there are many more categories of risks, including strategic risks (e.g., getting outcompeted by a competitor), reputation risks, liability risks and beyond.

There are three steps that businesses generally follow when they are managing the risk of harm. The first step is to identify the risk's impact, meaning the various places where the business can suffer, such as its income or valuation. The second step is for the business to assess how likely it is that the potential harms will materialize, and how severe or acute will the impacts of these harms be. In order to do that, the business must consider the factors that can affect the likelihood and severity of the risks. These include market conditions and all related factors that can have a bearing on the potential harm.

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This three-step process characterizes an appropriate risk management framework. It works for all manners of risks.

To illustrate, a business might identify that a decline in profit margin is a harm that it faces. One of the many factors that could cause this harm is changes in demand for its product that will change what it can charge. The business won't stop there, though. It will identify what trends or events will create a change in demand for its product. For example, the business will consider what market forces impact its core customer base. A slowdown in that sector might have a corresponding downward impact on the demand for the business's product. To illustrate, consider a builder of extra-large river barges in the upper Midwest. They know that "changes in demand" impact their risk, but they need to know what affects demand. Naturally, they look to key factors such as lower grain yield in the upper Mississippi River Valley (as lower grain yield may mean lower need for river barges). Both of these are factors that will impact the acuteness of the risk, *i.e.*, whether the harm is likely to happen and how severe it will be if it does happen. As a result, they may purchase short contracts on grain futures in order to hedge their risk.

Similarly, many businesses face potential harms that are impacted by inflation. Inflation can impact nearly all term contracts, impacting the business's real costs. For instance, a firm locked into a 10-year commercial lease on their office space will see lower real costs as a result of inflation than with a shorter lease. However, if the company is also a supplier and has locked in their sales contracts (e.g., they have agreed to sell 100,000 tons of fertilizer at \$900/ton), then the real value of those sales decline and inflation will harm them. Of course, inflation affects many other risks as well. Higher inflation raises the probability that the Federal Reserve raises its target interest rates, which tends to substantially reduce stock valuations and the value of assets.¹ Inflation is just one of many examples of factors that impact the likelihood and severity of

¹ The price of a stock is often considered the "discounted present value of future dividends". When the interest rate (a.k.a. the discount rate) goes up, then the present value of future dividends declines and thus the stock value declines. In simpler terms, when the interest rate goes up, it raises the relative value of present money over future profit. So an asset that incurs costs in the short-run but profits in the long-run is less valuable when interest rates are higher. A stock—which costs money in the short run but may generate dividends in the long-run—is thus less valuable when interest rates rise. That's doubly true for "growth stocks" that may be generating no profits now, but may generate them 5-10 years from now.

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potential harms. To mitigate those risks, they may seek to purchase any one of many inflation hedges, such as inflation swaps, inflation-protected Treasuries, or inflation event contracts.

B. Application to political control contracts

Political control represents another factor that could impact a company's risk profile, much like inflation. Firms use the same risk management strategy as before. A company first identifies harms—operational, reputational, valuation, credit, and more—and then identifies the ways those risks could change. The aforementioned fertilizer company may be purchasing fertilizer inputs like potash from other countries (potash is often found in Russia, Belarus, and China) and identify their largest operational risk as disruption in the global potash supply chain. They further identify that changes in congressional political control could increase the probability that the supply chain is disrupted since different Congresses may take different approaches to tariffs, sanctions and other trade-related policies. The election of a new Congress skeptical about status quo policy will immediately impact their business by reducing the expected revenues of current investments, new investments, and making partners and investors skittish. As a result, changes in political control directly increases (or decreases) the firm's operational risks.

Perhaps the clearest example of this description of risk management comes from the CFTC's report "Managing Climate Risk in the U.S. Financial System" ("CFTC Climate Report").² In Figure 2.1 (shown below) and expounded upon at length in Chapter 2 of the report, the report discusses transition risk, which is defined as the "risk associated with the uncertain financial impacts that could result from a transition to a net-zero emissions economy". They note that transition risk implicates "market, credit, policy, legal, technological, and reputational risks" for firms and must be a part of any honest risk assessment. Most importantly, the report specifically identifies how transition risks "could arise, for example, from changes in policy" along with other factors such as "technological breakthroughs, and shifts in consumer preferences and social norms".

As the Financial Stability Oversight Council corroborates, policy changes (along with technological change and consumer preference changes) "especially if delayed or uneven in application and therefore requiring more abrupt economic shifts—may lead to sharp changes in the values of certain assets or liabilities, impacting nonfinancial activity and the financial sector."³ As a draft rule from the Federal Reserve Board states, "Financial institutions with sound risk management practices employ a comprehensive process to identify emerging and material

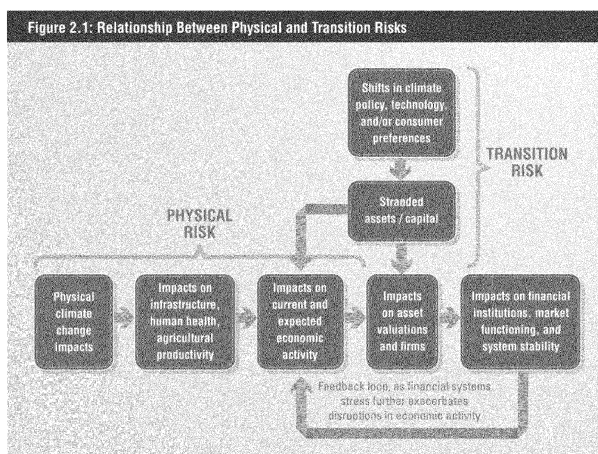
² Commodity Futures Trading Commission. 2020. "Managing Climate Risk in the U.S. Financial System". <https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf>

³ Financial Stability Oversight Council. 2021. "Report on Climate-Related Financial Risk" <https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf>

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risks related to the financial institution's business activities. The risk identification process should include input from stakeholders across the organization with relevant expertise (e.g., business units, independent risk management, internal audit, and legal). Risk identification includes assessment of climate-related financial risks across a range of plausible scenarios and under various time horizons.”⁴ As both reports show, firms *must* consider all of the risks facing their businesses, and the only honest and accurate way to do so is to consider the way changes in policy affect those risks. This analogy is drawn out further in Appendix L.



Commodity Futures Trading Commission. 2020. “Managing Climate Risk in the U.S. Financial System”. Page 12

C. Evidence of election risk and hedging need

Elections clearly impact myriad cash flows and assets. Political parties vie for office with credible commitments to affect public policy. As a consequence, elections portend risk for many firms with politically exposed cash flows and assets. The financial press frequently reports on how elections (and even changes in election polling) affect the prices of financial assets well before a new Congress has even been seated.⁵ Election hedging specifically is also often referenced in the financial press.⁶ Below, we present evidence from academic and private

⁴ Board of Governors of the Federal Reserve System. 2022. “Principles of Climate-Related Financial Risk Management for Large Financial Institutions.” <https://www.federalregister.gov/documents/2022/12/08/2022-26648/principles-for-climate-related-financial-risk-management-for-large-financial-institutions>

⁵ There are scores of articles which could serve as examples, but some are: Noel Randewich. 2020. “S&P 500 futures rise as U.S. election suggests less regulatory risk.” *Reuters*; Myra P. Saefong. 2020. “Here’s how the U.S. presidential election could shake up the oil market.” *Marketwatch*; Matthew Weaver. 2020. “Congressional elections could impact commodity prices most, expert says.” *Capital Press*.

⁶ There are scores of articles which could serve as examples, but some are: Weismann, Jordan. “Wall Street Says You Should Short Mexico to Prepare for Trump.” 2016. *Slate*; Brice, Jessica, and Cota, Isabella. “How Hedging and a Certain Someone Upended the Year of the Peso.” 2016. *Bloomberg*.

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research, firm testimony, and the comment file on Kalshi's previous submission detailing the existence of election risk and a core use case for Kalshi's Contract .

Academic research has consistently found that changes in political control result in changes to the prices of traded assets. For example, researchers Erik Snowberg, Justin Wolfers, and Eric Zitzewitz used a variety of prediction markets (including one permitted by the Commission, Iowa Electronic Markets) to establish a relationship between the odds of a given party's success in Congressional midterms and financial markets/indicators.⁷ They found that there was a consistent link between changes in expectations of who would control Congress and the prices of equities, government bonds, and the exchange rates between the U.S. dollar and foreign currencies. The fact that financial markets utilize political control as a pricing factor demonstrates that not only are elections something that should be hedged, but that firms are already hedging and repricing assets on public markets. If this is the case, there is no case to argue that elections are not "sufficiently predictable" events to hedge; the market is already doing so.

That same team looked at high-frequency trading data immediately following the release of (what turned out to be inaccurate) exit poll data which briefly caused a major change in the odds of a Democratic victory in 2004. Such a sudden spike during what is normally a quiet trading period allowed the researchers to isolate the effects of the changes in political expectations from other economic events during the same period. They concluded that markets expected a Republican victory to result in higher equity prices, interest rates, oil prices, and a stronger dollar than a Democratic one.⁸ They reperformed that analysis in 2016, where they found that markets anticipated that a Republican victory would reduce the value of the S&P 500, foreign stock markets, reduce oil prices, and lead to a significant decline in the Mexican Peso, while also increasing future market volatility compared to a Democratic win.⁹ A similar study in 2008 found that Democratic politicians polling higher than Republican ones was better for equity markets.¹⁰

Similarly, Northwestern professor Seema Jayachandran used a natural experiment to study the effects of changes in the partisan control of Congress.¹¹ In 2001, Vermont Senator James Jeffords switched parties from Republican to Democrat, shifting control of the Senate. In what she called "the Jeffords effect", the equity valuations of firms that donated to Republicans decreased by 0.4%, while the equity valuations of firms that donated to Democrats increased by 0.1%, again indicating the marketplace's belief that Congressional control has real, predictable consequences

⁷ Erik Snowberg, Justin Wolfers and Eric Zitzewitz. "Party Influence in Congress and the Economy." 2007.

⁸ Erik Snowberg, Justin Wolfers and Eric Zitzewitz. "Partisan Impact on the Economy". *Journal of Economic Perspectives*. 2004.

⁹ Justin Wolfers and Eric Zitzewitz. 2016. "What do financial markets think of the 2016 election?"

¹⁰ Demissew Diro Ejara, Raja Nag, and Kamal P. Upadhyaya, 2012. "Opinion polls and the stock market: evidence from the 2008 US presidential election." *Applied Financial Economics*.

¹¹ Seema Jayachandran. 2006. "The Jeffords Effect". *Journal of Law and Economics*.

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on firm valuations. Brown University economist Brian Knight found that “under a Bush administration, relative to a counterfactual Gore administration, Bush-favored firms are worth 3% more and Gore-favored firms are worth 6% less, implying a statistically significant differential return of 9%”.¹² Economist Andrea Mattozi found by regressing Bush- or Gore-affiliated portfolios against surprising poll results, “an increase in the probability of a Bush victory from 50 to 51 percent, increases the annual expected excess return of the Bush portfolio by 25 percent and decrease[s] the annual expected excess return of the Gore portfolio by 35 percent”.¹³ This finding—that changes in the expectations of who controls government affects the prices of assets—have been replicated time and time again.¹⁴

Financial assets are derivatives of real economic cash flows and commodities. For example, the stock of a company is representative of that company’s value, a function of its costs and cash flows. Thus, market participants are imputing elections’ impacts into those assets, suggesting markets believe that elections create economic risks, but those impacts are predictable enough to spend money repricing assets and hedging even in advance of policy decisions.

Consequently, banks regularly inform their clients as to how Congressional elections may impact their clients’ extant risks. In 2020, investment bank research divisions offered projections about the economic and financial impacts of various political outcomes. For example,

- Goldman Sachs’s chief economist stated publicly that full Democratic control of government would cause the bank to upgrade their earnings forecast by sharply increasing the probability that a large fiscal stimulus bill would become law.¹⁵ Full Democratic control would also, according to the bank’s insights, “likely include a stimulus package in Q1, followed by infrastructure and climate legislation. In this scenario, we would expect legislation expanding health and other benefits, financed by tax increases, to pass.”¹⁶

¹² Brian Knight. 2006. “Are policy platforms capitalized into equity prices? Evidence from the Bush/Gore 2000 Presidential Election” *Journal of Public Economics*.

¹³ Andrea Mattozzi. 2005. “Can we insure against political uncertainty? Evidence from the U.S. stock market”.

¹⁴ Examples abound, but also include, in addition to the research already discussed: Frederico Belo, Vito D. Gala, and Jun Li. 2013. “Government spending, political cycles, and the cross section of stock returns.” *Journal of Financial Economics*; and Kyle Handley and Nuno Limao. 2015. “Trade and investment under policy uncertainty: theory and firm. evidence.” *American Economic Journal: Economic Policy*; Bryan Kelly, Lubos Pastor, and Pietro Veronesi. 2016. “The price of political uncertainty: Theory and evidence from the option market.” *The Journal of Finance*.

¹⁵ Matthew Fox. 2020. “Goldman’s chief economist breaks down why a Biden-led blue wave would prompt an upgrade in growth forecasts”. *Business Insider*.

¹⁶ Thomas Franck. 2020. “Goldman Sachs says Democratic sweep would unleash ‘substantially’ more stimulus.” CNBC.

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- Morgan Stanley also cited the chance of stimulus along with infrastructure spending and corporate tax changes as a vehicle for a “blue wave” leading to a weaker dollar, lower interest rates, stronger GDP growth and lower bond prices.¹⁷¹⁸
- JP Morgan Chase projected that a Democratic victory would lead to a rally in ‘left-behind’ equities, such as “European cyclicals, value, China-exposed stocks and renewables.”¹⁹
- Bank of America provided roadmaps for each type of partisan outcome (e.g. one party controls all of government, divided government, et cetera). They wrote that full Democratic control of government would lead to \$2-2.5 trillion in stimulus compared to a Biden win with a divided Congress (\$0.5-1 trillion) or a Trump win with a divided Congress (\$1.5-2 trillion). They also detailed impacts to specific sectors, like businesses exposed to Chinese trade, in each scenario.²⁰
- UBS published a report noting partisan outcomes for policy and the economy, and recommended investors specifically focus on candidates’ policy commitments with regards to politically-sensitive industries like energy, health care, financials, and the environment. They noted that their investors should consider how the S&P 500 has performed best in environments where Republicans win, and their clients should make portfolio appropriate adjustments.
- Moody Analytics—not an investment bank, but a credit rating agency with a market research division—explicitly estimated that Democratic control of government would result in 4.2% growth between 2020-2024, compared to 3.1% under a Republican control scenario.²¹ They similarly projected a one percentage point lower unemployment rate and a 0.6 percentage point higher S&P 500 under a Democratic sweep.

This research is distributed, at great cost, to major financial institutions, especially capital pools like hedge funds and pension funds. This behavior strongly suggests that firms care a great deal about the specific impacts of elections on their assets, and take action to hedge their positions in advance. This was corroborated in a comment letter provided by a Managing Director of JPMorgan Chase. He wrote,

At JPMorgan, election risk is one of the largest risks our clients face, and they frequently engage us proactively on how to minimize it (hedge it, in other words). We work with and advise our clients on how to avoid that risk in their portfolios, especially when a client’s cash flows or investments are very politically sensitive (for example, those in the coal industry are very concerned regarding election outcomes and policy expectations).

¹⁷ Morgan Stanley. 2020. “A Revised Guide to Economic Policy Paths & Market Impacts”.

¹⁸ Morgan Stanley. 2020. “2020 US Election Preview: 5 Themes to Watch for Investors.”

¹⁹ Ksenia Galouchko. 2020. “JPMorgan Says Biden Victory Could Mark a Stock Market Shift.” Bloomberg.

²⁰ Bérengère Sim. 2020. “Bank of America wrote a massive 92-page report on the election’s impact — here’s what investors need to know.” Financial News.

²¹ Moody’s Analytics. 2020. “The Macroeconomic Consequences: Trump vs. Biden”.

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Since clients have different risk profiles, we do extensive research to fine-tune how these risks add up in our clients' positions. Our division employs a team of economists, at service to our partners, whose role in election years is heavily to research election probabilities as well as the impact election outcomes will have on equities and other investment products. We frequently host discussions with experts and clients on the relevant risks (including one coming up this week!) and publish research for both clients and the public.²²

In addition, businesses themselves often note electoral outcomes as an important factor in their value. In Q3 2020, more than one-third of company quarterly earnings conference calls used the term 'election' in the context of their financial assessments and projections.²³ On these calls, concerns were most frequently raised regarding regulatory changes that would impact business, as well as tax reform and additional potential fiscal stimulus. Earnings calls also frequently included discussions regarding the economic and business impacts of different political control outcomes (e.g., a "blue wave", divided government, et cetera). Consider this fall 2020 testimony from Thomas Peterffy, Chairman of Interactive Brokers, a brokerage firm:

Well, in the last couple of weeks, we do notice some moderation in activity, and -- which would be expected as we come up to the election. And then, of course, I think it will pick up when the results come out, especially if the Senate goes Democratic, I expect that people will start taking the long-term gains because of the expected 43% long-term capital gains tax rate. And then of course, we are looking further down the road, more and more spending that will result in asset inflation, including higher and higher stock prices.

The marketplace's expectations of the impacts of changes in political control are so credible that the Federal Reserve uses them when making monetary policy decisions. For example, during the December 2012 Federal Open Market Committee meeting, Simon Potter, the Federal Reserve's Head of Economic Research said:

The outcome of the election reinforced investors' expectations for a continuation of highly accommodative monetary policy...Some market participants also believe that there is an increased chance of housing policy changes following the election, which would increase refinance activity and origination volumes associated with credit-constrained borrowers.²⁴

Commenters on Kalshi's previous submission overwhelmingly argued in favor of the Contract's risk mitigation value. This included industry leaders (such as Jorge Paulo Lemann, Christopher Hehmeyer, Ron Conway, Seth Weinstein) and owners of politically sensitive businesses (such as those of Continental Grain Company, Nabis, Greenwork, Upsolve) who specifically discussed

²² Public Comment by Angelo Lisboa. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69666>.

²³ John Butters. 2020. "More than one third of S&P 500 companies are discussing the election on Q3 earnings calls." Factset.

²⁴ Meeting of the Federal Open Market Committee. December 11–12, 2012.

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hedging use cases for their companies.²⁵ This included Greg Sirotek, the co-founder and CEO of Moneytree Power, a startup dedicated to installing solar power:

Congress has an incredible influence over the future of the zero-carbon energy industry, particularly the solar industry...Given the respective differences in the two parties' positions on the importance of climate change mitigation, renewable energy development and the deficit, the risk profiles depending on which party is in power is vast. An event contract which pays out on the basis of Congressional control would allow our business to manage this previously unhedged risk.²⁶

Jorge Paulo Lemann, a founder at 3G Capital and a Board member of firms like AB-InBev and Kraft Heinz (some of the largest participants in traditional agricultural futures), wrote:

These statements [claims that there are no hedging or price basing use cases for election contracts] are inconsistent with the preponderance of the academic research on the subject and is inconsistent with the actual experience of anyone who has ever operated a business in or with the United States or traded on the global commodity markets. Experience and empirical observation show that elections have consequences, and these consequences directly create risk that can be hedged, and are factored into pricing commodities, financial assets, and services.²⁷

Hehmeyer, former Chair of the National Futures Association and Board Member of the Futures Industry Association, added that many are affected regardless of policy outcomes:

For example, media personalities and companies face risk from Congressional control and elections. Early professionals hoping to work on Capitol Hill know there are far more positions available if their preferred party is victorious, as there are more Congressional offices and committee positions for them to staff. A consultancy that specializes in specific topic areas (for example, a green energy consultancy) may know the demand for their services will decline in anticipation that their issue of expertise is less likely to be operative under a split Congress. These risks occur regardless of the legislation that actually passes. There are billions of dollars at risk surrounding the outcome of Congressional control and elections. These risks can reasonably be expected to be managed through this contract on Congressional control.²⁸

Although some commenters claimed election outcomes aren't predictable enough to be a useful hedge, that in no way contradicts or even diminishes those who say the opposite. At most, those commenters do not see hedging utility for themselves. They cannot credibly say that all the firms who identified how they would use the contracts for hedging and managing their risk are mistaken or deficient in their ability to recognize risk and potential tools to manage or mitigate that risk. It would be arbitrary for the Commission to listen only to the few who assert that there

²⁵ Public comments 69668, 69715, 69667, 69683, 69678, 69619, 69684, 69717, 69714, 69718, 69727, 69707, 69677, 69655.

²⁶ Public Comment by Greg Sirotek. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70751>.

²⁷ Public Comment by Jorge Paulo Lemann. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69684>.

²⁸ Public Comment by Christopher Hehmeyer. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69717&SearchText=christopher>.

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is no hedging use case for anyone when most others who state that they would use the product for themselves or their business.

Thus, it is clear that businesses consider political control an important risk to be hedged. This reality is recognized by the CFTC in the CFTC's Climate Report and the aforementioned FSOC report. It noted that, "uncertainty associated with policy risk is already penalizing oil companies that are investing in undeveloped fossil fuel reserves" and "financial market participants are already looking for ways to manage transition risk in their investment portfolios."²⁹ The partisan makeup of Congress is a critical factor of policy risk that Kalshi's Contract addresses.

Even if the above evidence was not clear, the market is best positioned to make that determination, not the Commission or Kalshi. If that risk is too tangential, then the product will be a commercial failure. With a contract designed for hedging, such as this contract with its minimum order size and increased position limits, the market and market participants will be able to determine their own risk management strategies, and whether the contract is a necessary component of their strategies or not. That is a decision that is appropriately left to the participants to decide for themselves.

D. How the CONTROL contract can be used to hedge political risk in practice

Note that the CONTROL contract is not a panacea that can hedge all risks. It is not appropriate for all market participants, and it is not appropriate for all risks. The CONTROL contract is appropriate for businesses that face risk impacted by partisan political control of Congress. For those businesses, the CONTROL contract can be an important hedge and part of their overall risk management process. A typical business that has risks that are impacted by political control will have risks that are appropriately hedged by the CONTROL contract, as well as risks that are not. The following examples illustrate the risk management analysis a typical business will follow, with risks that are impacted by political control and risks that are not, in order to illustrate how the contract fits into a broader risk management strategy that a firm may undertake.

Though the comment file (and other evidence discussed in Section C above) provide many tangible examples of firms describing the risks they are subject to and would use the Contract to mitigate, Section D will include detailed descriptions of firms' hedging. Consider an enhanced geothermal systems company producing process heat for industrial processes (e.g. paper mills). The business will identify the potential harms that the company faces. Naturally, there are many operational risks (what if a rig breaks?), but those are hardly the only risks they face. Some other risks are enumerated below:

²⁹ Commodity Futures Trading Commission. 2020. "Managing Climate Risk in the U.S. Financial System".

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- Increases in transportation costs, which could affect the cost of transporting specialized boring equipment. This may occur due to increases in trucking rates or changes in gas/diesel prices. For illustration, let us say that every 1% increase in transportation costs costs the firm \$200,000.
- Changes in the price they can sell their goods, which could occur due to rising energy prices or government rebates. For example, suppose a 1% increase in energy costs increases firm profits by \$500,000.
- A shift in the demand curve for their services. There is a subtle but important distinction between changes in services demand due to lower prices (which in economic terms would be considered a move along the same demand curve) and a shift in the demand curve, whereby demand is different even if the price remains the same as before. This scenario could occur due to changes in environmental rules inducing more industrial firms to purchase zero-carbon electricity or changes in subsidies and tax credits that makes their product more affordable for firms when compared to fossil fuel services. Suppose a *ceteris paribus* 1% increase in demand would increase firm profits by \$300,000.
- Changes in retained profits. This could occur due to changing revenues, changing costs, but also changing corporate tax rates—including marginal rates and depreciation treatment. Suppose reversing the 2017 tax cuts would, all else equal, increase firm costs by \$5 million.
- Changes in expansion opportunities. This could occur due to changes in permitting standards that may affect the speed at which the firm can develop new geothermal sites or changes in environmental standards may affect which sites can be developed.
- Changes in expansion costs. This may occur due to changes in interest rates may affect the cost of financing new rigs and sites or changes litigation costs from NEPA rules that affect whether local groups can sue to stop a new site development.

The firm will assess what are the factors that will impact each of their potential harms, factors that can impact the likelihood of harms materializing, and factors that can impact the severity of harms should they materialize. Not every harm will be directly impacted by elections and political control, and the contract will not be a part of every hedging strategy. Looking at the transportation cost variable, for instance, the firm may decide that trucking rates are likely unaffected by changes in Congressional control (though in 2022, Congress's vote on the freight rail strike did likely affect trucking prices, a firm may not consider this frequent enough to be worth calculating) and gas prices—while related to political variables—is not easily anticipated by changes in Congressional majorities. Regarding their output price, while wholesale energy prices are certainly influenced by political variables, the firm may determine that the relationship to elections are too attenuated to evaluate. Likewise, while permitting standards under the National Environmental Policy Act is a top priority for the 118th Congress, it's widely viewed as a bipartisan priority and thus unlikely to change regardless of how political conditions evolve.

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But the business may determine that other potential harms will be directly impacted by elections and political control. For example, retained profits and shifts in the demand curve are influenced by which party wins Congress, as parties have substantially different positions on corporate taxes, zero-carbon subsidies, and emission standards for industrial processes.³⁰ As a result, depending on how the Congressional election plays out, certain risks become more salient. Mitigatory actions may be insufficient—the firm cannot cost-efficiently diversify into fossil fuels to reduce their exposure to clean energy subsidy policy in the same way a corn farmer cannot cost-efficiently diversify into an uncorrelated domain in order to reduce their exposure to agriculture prices. A firm may conduct some simple math: a given party winning may increase the probability of beneficial tax changes by 20%, creating an expectation of \$1 million (\$5 million * 20%) more in retained profits, but have a 50% chance of enacting environmental rules that reduce demand by 10%, creating an expectation of loss of \$1.5 million (50% * 10%/1% * \$300,000). As a result, a financial hedging product may be more appropriate. Suppose the probability of Party X winning control of Congress was 33.3% and the price of the \$5000 contract was thus \$1,666.67. In that case, they would purchase 60 contracts for a total of \$100,000. If the adverse event does occur, the firm would be paid \$300,000 to compensate for their expected losses. If the adverse event does not occur, they would not be paid, but they would reap the benefits of the more favorable event occurring.

The chart below summarizes this process. **Green-colored rows** indicate risks that can be mitigated using the CONTROL contract, whereas **magenta-colored rows** indicate risks that would not be hedged by the CONTROL contract.

Potential Harm (Risk)	Factors that could affect the likelihood and severity of the risk	How these risks could be hedged
Transportation cost increases	<ol style="list-style-type: none"> 1. A potential labor strike on the railroads increases trucking rates as rail freight shippers must all now shift to trucking temporarily 2. Russia's war in Ukraine increases the global price of gasoline and diesel fuel 	There is a relationship to Congressional control, but it's likely too attenuated for the Contract to be a useful hedge. Instead, the firm purchases short-contracts on WTI oil and buys long-term trucking contracts

³⁰ This is not just rates. The tax code is filled with numerous and interrelated provisions that impact businesses in different ways. The business may have a number of different provisions that, while seemingly minor to the average citizen, impact them deeply. For instance, while millions of companies are affected by the headline marginal tax rates (making marginal tax rates a good candidate for a policy-specific event contract), a small number are affected by individual provisions such as the treatment of carried interest (for hedge funds) or easements for wetland protection. However, for the firms for which those "minor" provisions matter, they matter a great deal. In order to get enough liquidity, those firms would essentially pool their liquidity on a general Congressional control contract, where the firms who care about each of the thousands of minor provisions all might participate.

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<p>Sales price decreases</p>	<ol style="list-style-type: none"> 1. Large-scale technological advances in hydraulic fracturing technology decreases the price of natural gas, lowering the price by which energy can be sold competitively to industrial users 2. New Congress decreases government zero-carbon energy subsidies previously authorized under the Inflation Reduction Act that were given directly to zero-carbon producers 	<p>Similarly to transportation, the relationship to energy price changes is real but better hedged through oil futures. However, the subsidy risk remains real, and the forms it takes are too manifold to hedge using a specific policy-product, and instead the firm buys Contracts that hedge against a subsidy-hostile Congress winning power</p>
<p>Loss of demand</p>	<ol style="list-style-type: none"> 1. Changes to the overall federal legislative and regulatory approach to energy policy that no longer encourage industrial users to use zero-carbon electricity in the same way 2. Recession results in decreased manufacturing in the business's service area 	<p>Recession risk is best hedged using other instruments—such as shorts on the S&P 500 or a recession-specific event contract. But changes to the overall legislative approach to energy policy is best hedged using a contract that pays out on the basis of Congressional control</p>
<p>Loss of retained profits</p>	<ol style="list-style-type: none"> 1. New Congress reverses the marginal corporate tax rate cuts and bonus depreciation provisions authorized under the Tax Cut and Jobs Act of 2017 2. New Congress introduces new surtaxes and surcharges onto large corporations as part of an effort to reduce the deficit 	<p>TCJA reversal may be able to be hedged using a specific policy-level event contract. However, the second channel is too broad or general for a policy-specific contract, and instead the firm would buy a contract that pays out on the basis of a tax-friendly Congress taking power</p>
<p>Higher input costs</p>	<ol style="list-style-type: none"> 1. New Congress has a more protectionist stance, and has various proposals to—among other things—renegotiate existing trade agreements, reject newly proposed agreements, impose new tariffs on foreign goods, increase regulatory scrutiny on foreign investments, and globally signal a new attitude on trade policy 	<p>The trade uncertainty channel is too broad or general for a policy-specific contract, and instead the firm would buy a contract that pays out on the basis of a more protectionist Congress taking power</p>

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Loss of demand	<ol style="list-style-type: none"> 1. A new Congress has a more restrictive view on antitrust policy and will work to reduce the number and size of mergers and acquisitions through a combination of new legislation, changing personnel in relevant bureaucratic agencies (such as the Federal Trade Commission), and asking those bodies for new regulations 	The decline in M&A activity, as well as general uncertainty in the sector, is too broad or general for a policy-specific contract, and instead the firm would buy a contract that pays out on the basis of a more anti-M&A Congress taking power
Business model regulated or destroyed	<ol style="list-style-type: none"> 1. A new Congress believes that a particular industry or business is socially harmful and decides to ban it, either directly or indirectly through regulation and bureaucratic appointments. Congress has considered doing so with many firms and industries, such as Tik Tok and e-cigarettes 	A business model being regulated in a punishing way is too broad or general for a policy-specific contract, and instead it would make more sense for the firm to buy a contract that pays out on the basis of a hostile Congress taking power
Loss of expansion opportunities	<ol style="list-style-type: none"> 1. Judicial action strikes down modifications to state-level permitting law reforms, thereby allowing frequent NEPA litigation over site development 2. Interest rates, monetary policy, and tax changes make venture capital markets go tighter, and reducing the access to capital markets 	There are no good hedges to state-level judicial action, and instead the firm should “self-insure” by maintaining a capital buffer. Changes in interest rates and monetary policy can be hedged using other financial instruments, such as interest rate swaps
Increase in expansion costs	<ol style="list-style-type: none"> 1. An unexpected surge in inflation causes the Federal Reserve to hike interest rates, thereby raising the cost of borrowing money to build new rigs 	Increases in inflation and interest rates can be hedged using inflation-protected treasuries or interest rate swaps

Or consider a firm specializing in providing specialized lab-developed tests (LDTs) for certain genomic conditions. They regularly take stock of their company’s biggest risk factors. They include:

- Changes in research and development financing costs. Three major factors include changes in funding to the National Science Foundation (NSF) and National Institutes of Health (NIH), changes in interest rates, and research and development tax breaks. They

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estimate that every 1 percentage point increase in interest rates increases their costs by \$5 million.

- Changes in regulatory approval costs. One major contributor to the risk is the probability that Congress changes the law such that LDTs are treated the same as all commercial-use diagnostic tests, thereby changing from the regulatory remit of the Center for Medicare Services (CMS) to the Food and Drug Administration (FDA), where approval timelines are typically substantially longer. They estimate that change would add an additional six months to their approval process, which could cost them roughly \$25 million per year.
- Changes in revenue and profit, which could be affected by changes in Medicare reimbursement rates, which may affect the willingness of hospitals to offer their tests. They estimate that a reduction of 1% in the Medicare reimbursement rate change would cost them \$10 million per year. Another factor related to this risk is changes in corporate taxes, including marginal rates, which may affect overall profitability. They estimate reversing the 2017 corporate tax reductions could cost their company \$3 million.

The firm may determine that NSF/NIH funding remains a bipartisan priority and is unlikely to change regardless of the results of the Congressional elections. Likewise, the effect on interest rates from Congress may be too attenuated to effectively assess; but they determine that legislation to change the regulatory treatment of LDTs is more likely under one political coalition than another. Since they are a firm specializing in LDTs, this risk could be quite severe. As a result, they may wish to purchase a financial product that mitigates their risk exposure.

The relationship between the election and their risks is sufficiently direct that a financial hedge may be valuable. For instance, suppose they believe that Party X winning the midterm election would result in a 16 percentage point increase in the probability that LDT reform legislation becomes law. As a result, the election of Party X creates \$4 million in risk through that channel alone ($0.16 * 25m$). However, Party X winning also reduces the probability of costly corporate tax changes by 33%, thereby reducing the expected loss by \$1 million. As a result, they may wish to purchase \$3 million of hedging products to zero out their extant election risks, which they could do so by purchasing 3,000,000 contracts. They may also wish to only partially hedge by purchasing less than that. Critically, even though the election is not deterministic on their bottom line, it has clear and unambiguous effects on risks to their profitability that can be hedged.

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How hedging political risk works

Example of how a lab-developed test company will hedge

Step 1: Identify risks to businesses

1. Changes in R&D financing costs
2. Changes in approval costs
3. Changes to net revenue and profit, including tax rates

Step 2: Determine likelihood of risks

- The firm determines that Risk 1 is unlikely to be affected by the partisan control of Congress, but Party X has committed to affect Risk 2 in a negative way for the firm. Party X has also committed to tax policy that would benefit the firm.

Step 3: Determine the hedge

- I determine that those risks represent \$3 million of potential loss on net if party X wins.
- I determine that a \$3 million dollar hedge is appropriate to zero out that risk.

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Hedging example ECP (cont.)

Risk	Magnitude	Probability if Party X has control
Adverse change in regulatory regime	\$25 million	16% higher
Beneficial tax reduction	\$1 million	33% higher

Hedge: If Party X wins, the increase in risk to the company is \$3 million (-\$4 million from regulatory changes and \$1 million from the tax changes). They may look at the prices of the contract, and may decide to hedge against that risk fully, purchasing contracts that in total payout \$3 million if Party X wins. If Party X loses, they lose the money they spent but they benefit from Party X being out of power.

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E. Similarities to existing products

Many products listed on Commission-regulated exchanges mitigate risk in a similar manner to Kalshi’s proposal. For instance, the CME Case-Shiller futures, which pay out based on an index that tracks the overall housing market, does not perfectly map onto any real estate portfolio. It is nonetheless a useful hedging product. Below we have assembled a table that highlights relevant characteristics of existing self-certified products.

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Self-certified contract	Relevant characteristics	Comparison to Political Control Contracts
Micro Bitcoin futures	<ul style="list-style-type: none"> • Geared towards retail participants • The micro size itself does not hedge real economic activity • Does not have price-basing value for other goods and services 	<ul style="list-style-type: none"> • Geared towards retail/firms (original Kalshi submission) or just entities (current submission)³¹ • Allows for hedging real economic activity, even if not 1:1 • Provides valuable price-basing for pricing other assets such as oil, currencies and equities
Cooling and Heating Degrees futures (there are many dozen variations of these, for particular areas and seasons)	<ul style="list-style-type: none"> • Does not perfectly hedge 1:1 anyone's risk, since the primary purchasers (natural gas companies, air conditioner companies) are exposed to energy consumption, but that does not line up either 1:1 with weather or with CDD/HDD 	<ul style="list-style-type: none"> • Similar hedging value proposition: primary purchasers' risk is correlated strongly with elections, even if not perfectly correlated
Case-Shiller Housing Price Index futures (and other real estate futures products)	<ul style="list-style-type: none"> • Does not perfectly hedge 1:1 anyone's risk, since the primary purchasers (real estate investors) have risk that is correlated, but not perfectly correlated, with the overall real estate market and any index in particular 	<ul style="list-style-type: none"> • Similar hedging value proposition: primary purchasers' risk is correlated strongly with elections, even if not perfectly correlated
Hurricane contracts	<ul style="list-style-type: none"> • Does not perfectly hedge 1:1 anyone's risk, since it is uncertain whether a hurricane of a given speed hitting a given area will cause any amount of damage at all, let alone damage to the user, and to what severity 	<ul style="list-style-type: none"> • Similar hedging value proposition: primary purchasers' risk is correlated strongly with elections, even if not perfectly correlated
Equity index	<ul style="list-style-type: none"> • At their inception, equity 	<ul style="list-style-type: none"> • Similar hedging value

³¹ Although the contract will be available to all Exchange members, as required by the CEA and Core Principle 2.

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<p>futures (there are many dozen variations of these live on commodity futures exchanges, e.g. CME's E-mini Utilities Select Sector Futures)</p>	<p>index futures were designed to capture the risks investors faced from the market as a whole. However, the particular indices (such as the S&P 500) do not perfectly capture and hedge 1:1 anyone's risk. Their risk is correlated, but not perfectly correlated, with the overall market. Though some index futures have products that directly reflect them (e.g. S&P 500 ETFs) today this is not true of all index products listed, nor true of any hypothetical product</p>	<p>proposition: primary purchasers' risk is correlated strongly with elections, even if not perfectly correlated</p> <ul style="list-style-type: none"> • Many iterations (e.g. e-Minis, Micros) are targeted and used heavily by retail (original Kalshi submission) or by institutions (current submission)
<p>Consumer Price Index futures</p>	<ul style="list-style-type: none"> • Though individuals and firms are subject to inflation risk, their particular inflation risk is not generally not perfectly correlated with the consumer price index, which chooses a particular set of goods in a particular composition in order to measure inflation 	<ul style="list-style-type: none"> • Similar hedging value proposition: primary purchasers' risk is correlated strongly, though not perfectly with the derivative product in question
<p>CBOE's Volatility Index (VIX)</p>	<ul style="list-style-type: none"> • Though individuals are affected by the risk associated with the stock market, they are not perfectly affected by the risk implied by S&P 500 options 	<ul style="list-style-type: none"> • Similar hedging value proposition: primary purchasers' risk is correlated strongly, though not perfectly with the derivative product in question
<p>Environmental offset futures</p>	<ul style="list-style-type: none"> • In this case, purchasers are not even offsetting personal risk. They are offsetting social risk, risk to society that is caused by their operations; as well as the marginal risk caused to 	<ul style="list-style-type: none"> • Similar hedging value proposition: primary purchasers' risk is correlated, though not perfectly with the derivative product in question

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	them by increased carbon output	
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F. Focus on large-scale hedging

Class	Bona fide hedgers	Everyone else
Individual	\$250K	\$125K
Entity	\$10M	\$5M
ECP	\$100M	\$50M

Position limits for different users of Kalshi's CONTROL contract

Critically, this product is designed for firms, ECPs, and other large-scaled hedgers, although of course individuals are not prohibited from trading, as required by Core Principle 2. The contract order size (multiples of 5,000 contracts) is appropriate for large scale financial hedging activity.

While it is true that not all participants will be hedgers (as with other futures, there need to be some non-hedgers to provide liquidity), with the high contract order size and larger position limits for ECPs and entities, it is highly likely that these non-hedging participants will be sophisticated firms and specialized liquidity providers, which is a dynamic found in many CFTC-regulated markets.

G. Price basing and price discovery utilities

There is extensive price basing utility for the Contract. As discussed earlier, the market frequently reprices assets on the basis of changes in election expectations and election outcomes.³² Investment banks and other research divisions provide clients and the public with recommendations on how Congressional outcomes will change the price of financial assets; an event contract on election outcomes would help price discovery for those products. For example, in 2020, projected a one percentage point lower unemployment rate and a 0.6 percentage point higher S&P 500 under a Democratic sweep.³³

³² There are scores of articles which could serve as examples, but some are: Noel Randewich. 2020. "S&P 500 futures rise as U.S. election suggests less regulatory risk." *Reuters*; Myra P. Saefong. 2020. "Here's how the U.S. presidential election could shake up the oil market." *Marketwatch*; Matthew Weaver. 2020. "Congressional elections could impact commodity prices most, expert says." *Capital Press*.

³³ Moody's Analytics. 2020. "The Macroeconomic Consequences: Trump vs. Biden".

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In 2012, more than two dozen economists signed a letter to the Commission supporting arguing as much. Led by the late Nobel Laureate Kenneth Arrow in that 2012 letter, they wrote:

Political event futures facilitate price discovery in other asset markets. One of the findings of [our] research is that firms and industries are exposed to political and policy risk. Political event futures provide investors with a market-based assessment of outcome probabilities, which reduces investors' uncertainty when trading other assets.³⁴

Many economists have done the same for Kalshi's previous submission, including Nobel Laureate Robert J. Shiller, Phillip Tetlock, Justin Wolfers, Scott Sumner, Michael Abramowicz, Joseph Grundfest, Alex Tabarrok, Michael Gibbs, Jason Furman, David Pennock, Harry Crane, David Rothschild, Koleman Strumpf, Ryan Oprea, and others.³⁵ A letter signed by Pennock, Crane, Rothschild, and Strumpf argued,

Prediction market prices in political and policy events would help facilitate price discovery in a wide-range of asset markets, affecting the entire economy (note that pricing is freely available to non-traders). Political and policy events matter: they expose a wide-variety of businesses to risk that traditional financial markets have trouble pricing. A robust set of markets for political and policy events could price that risk, and, if they were allowed to flourish, could eventually grow to provide hedges where uncertainty is particularly acute.³⁶

The contracts can also be used to price MGEX's corporate tax futures and Kalshi's other political event markets related to bills passing, government shutdowns, and the debt ceiling. They can also be used to price other nonpolitical products, like equities and bonds. For example, imagine a junior investment bank has been instructed to price a security. That price is reflective of the stocks' net present value, itself a reflection of future expected profits. This includes political risk. If that banker knew with certainty that Republicans will take control of Congress, for example, and corporate taxes are thus less likely to be raised, she would price the security higher than otherwise. Kalshi's contracts would help her in doing so.

Many other members of industry and businesses stated as much in public comments, including Angelo Lisboa, Peter Kempthorne, Seth Weinstein, David Pollard, David Trinh, Eriz Zitzewitz, James Cust, Caesar Tabet, Jorge Paulo Lemann, Sebastian Strauss, Christopher Hehmeyer, and Ron Conway.³⁷ Margaret Stumpp, a senior vice president at Prudential Financial and a co-founder of Quantitative Management Associates, wrote,

³⁴ Nadex public comment by Zitzewitz et al. Available at <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/ericzitzewitzltr020312.pdf>.

³⁵ See public comments 70761, 69708, and 69735.

³⁶ Public Comment by David Rothschild. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69735>.

³⁷ See public comments 69662, 69703, 69718, 70743, 70763, 70747, 70753, 70765, 69684, 69721, 69717, and 69714.

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...a well functioning market for contingent political outcomes should improve the prices at which other securities (eg, stocks, bonds, options, etc...) trade. This reduces uncertainty, enhances capital market liquidity, and improves the efficiency by lowering uncertainty.³⁸

On the standard for price basing

One commenter argued that there is no hedging or price basing use case for the Contract because there is no underlying cash market, unlike with traditional agricultural and energy derivatives.³⁹

This is not the standard that the Commission should apply in its decision. It is not the standard applied in *Nadex* (which considered whether *Nadex*'s proposal could base the price of a physical commodity, financial asset, or service); it is also not the standard that the Commission asked the public to use in judging *Kalshi*'s original submission (which uses the same test as *Nadex*). To do otherwise and limit price basing to only contracts with an underlying cash market would be arbitrary.

It would also essentially invalidate the existence of price basing, or price discovery, for the vast majority of event contracts, which do not have underlying cash markets. This is inconsistent with Commission precedent and would upend myriad products listed with the Commission in the last two decades. Many derivatives products currently listed with Commission-registered Designated Contract Markets do not have underlying cash markets, such as:

- Macroeconomic indicator derivatives (e.g. Gross Domestic Product contracts)
- Tax rate derivatives (e.g. MGEX's corporate tax rate futures)
- Weather derivatives (e.g. hurricane and heating/cooling degree days contracts)
- Carbon offset futures (e.g. CME's CBL Global Emissions Offset Futures)
- Housing price index futures (e.g. CME's futures based on Case-Shiller house price indices)

Because of the permissionless nature of self-certification, the Commission has not *specifically* stated that the above contracts have hedging or price basing utilities; the Commission did so implicitly by permitting their registration for decades. However, in some cases, the Commission has been specific. For example, the Commission actively determined that futures which pay off based on the amount of box office revenue a motion picture produces has price basing utility, even though it has no cash commodity market.⁴⁰

³⁸ Public Comment by Margaret Stumpp. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69722>.

³⁹ Public Comment by Steve Suppan. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70791>.

⁴⁰ "The Commission found that the contracts can perform hedging and price discovery purposes...The Commission analysis applied three tests to determine whether or not these contracts could be used by an identifiable segment of an industry or industries for hedging or price basing on more than an occasional basis."

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The price basing value of Kalshi's proposal is no different. A market-based determination of the probability of a given party taking control of a given chamber of Congress would be helpful in basing the price of politically sensitive commodities (such as oil), assets (such as politically sensitive stocks, like cannabis and energy firms), and services (such as investments in politically sensitive sectors).

There is no hard and fast rule defining when price basing does and doesn't occur in a manner sufficient to justify a CFTC-listed derivative. In some cases, the Commission/Commission staff indicated that price basing is when a commodity future specifically bases the price of its underlying commodity; in other cases, also related commodities;⁴¹ in other cases (including Kalshi's), also non-commodities.⁴²

Several Commissioners have indicated in statements they believe that intangible event contracts, sans cash markets, have price basing utility. This includes Commissioners Brian Quintenz and Dan Berkovitz in the case of ErisX's proposed NFL Futures Contracts; Commissioner Sharon Brown-Hruska when discussing how event contracts may have primarily price discovery as opposed to hedging functions; as well as Commissioners Quintenz and Mark Wetjen on election contracts themselves.⁴³⁴⁴⁴⁵⁴⁶ In fact, in its release discussing event contracts in 2008, Commission

<https://www.cftc.gov/sites/default/files/idc/groups/public/@otherif/documents/ifdocs/mdexcommissionstatement061410.pdf>.

⁴¹ For example, the CFTC's rule on Exempt Commercial Markets describes price basing this way at some points, as does the definition provided on the Commission's website; at other points, the rule refers to price basing as being about only the underlying commodity itself.

⁴² For example, the Commission's decision in *Nadex* or the Commission's questions for the public in Kalshi's original submission specifically discuss whether the contracts can be used for basing the price of a physical commodity, financial asset, or service. The Commodity Exchange Act also does not specify what derivatives must or should be managing price risk/discovering prices/price basing for.

⁴³ Statement of Commissioner Dan M. Berkovitz Related to Review of ErisX Certification of NFL Futures Contracts, April 7, 2021, available at

https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement040721#_ftn27 Note: Commissioner Berkovitz argues that, although he does not believe ErisX demonstrated price basing utility, he does clarify that it could have such utility, and is open to being shown that.

⁴⁴ The Functions of Derivative Markets and the Role of the Market Regulator, May 18, 2006. Dr. Sharon Brown-Hruska, Commissioner, available at

<https://www.cftc.gov/PressRoom/SpeechesTestimony/opabrownhruska-45>

⁴⁵ See Public Comment on Kalshi Contract from Brian D. Quintenz, available at:

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70786>

⁴⁶ See Public Comment on Kalshi Contract from Mark Wetjen, available at:

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70771>

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staff used election markets to describe how price discovery in event contracts could work.⁴⁷ This utility was true then, and it remains true today.⁴⁸

The law, similarly, does not restrict price basing to specifically the commodity upon which the derivative is based. Specifically, the CEA says, “transactions subject to this Act are entered into regularly in interstate and international commerce and are affected with a national public interest by providing a means for managing and assuming price risks, discovery prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities.”

Even if the Commission had used the standard whereby price basing only applies to an underlying cash market (and it has not) at one point, why should it continue to do so in the future? The fact that a derivative can provide price discovery for a different commodity, asset, or service is consistent with the CEA’s price discovery goals; stopping a derivative from being listed on that basis is inconsistent with it. Moreover, the fact that a derivative could be used for price discovery for another kind of product or service suggests relation, falling within one of the common definitions Commission staff use in describing price basing.

That being said, if the standard was “related” commodity, election markets are patently related to major commodity markets, such as energy and agricultural markets. The United States government is a major participant in such markets, both directly trading in them and providing significant industry subsidies. In addition, research has consistently found a link between elections and changes in oil prices, demonstrating that the market is using election probabilities to base the price of commodities and commodity futures.⁴⁹

H. Other comments on hedging and pricing issues

A few commenters disputed the hedging and/or price basing utilities of the contract in ways that are not addressed by the above. They said:

⁴⁷ As noted above, the Commission’s release stated that “The trading of such contracts can facilitate the discovery of information by assigning probabilities, through market-derived prices, to discrete eventualities. For example, a binary contract based on whether a particular person will run for the presidency in 2012, can pay a fixed \$100 to its buyer if and only if that individual runs for the presidency in 2012. If the contract’s traders believe that the likelihood of the individual’s candidacy in 2012 is around 17 percent, the price of the contract will be around \$17, and will approximate the market’s consensus expectation of the individual’s candidacy.”
<https://www.federalregister.gov/documents/2008/05/07/E8-9981/concept-release-on-the-appropriate-regulatory-treatment-of-event-contracts>

⁴⁸ The fact that the concept release predated Dodd-Frank is of no consequence. The point is that the contract has obvious price basing utility, and even if Dodd-Frank, *arguendo*, reincarnated the economic utility test, the contract passes because of its price basing utility.

⁴⁹ *E.g.* Erik Snowberg, Justin Wolfers and Eric Zitzewitz. “Partisan Impact on the Economy”. *Journal of Economic Perspectives*. 2004.

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- The \$25,000 position limit was not enough to constitute hedging for most businesses and institutions. In Kalshi's new submission, the position limits have been raised, with an emphasis on those with established hedging needs.
- Election outcomes are not sufficiently predictable in order to justify a hedging product. Above, evidence is provided that market participants extensively discuss, hedge, and price election risk well before a new Congress is even seated. If the market is already doing so, then there is no place to say otherwise.
- Election risk can be de-risked through other equities and derivatives products. However, other products are insufficient to hedge electoral risk, which is a unique risk that could flow through many different parts of a firm's business. Moreover, there is no "uniqueness" requirement that hedging products have.
- One commenter, Richard Q. Wendt, argued that hedging behavior would reduce the Contract's informational utility, since hedgers are less price sensitive than speculators. However, large, liquid markets with hedgers, speculators, and liquidity dealers are broadly able to simultaneously provide accurate pricing information and hedging opportunities. For example, when the price of an oil future is pushed down below fair market value by a price insensitive hedger, speculators come in and push the price back up to take advantage of the discrepancy between the current price and the fair price.
- The Commission, in its questions, questioned whether it should be considering what percentage of a given market must be made of hedgers versus speculators; as well as whether hedging needs can be merely theoretical or need "evidence". These standards were not applied against Nadex, ErisX, or any other contract proposed to the Commission. They are not found in law, rule, or regulation; although Kalshi's contract clearly does have established hedging utility, it would be arbitrary for the Commission to impose novel burdens on it.

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*KalshiEX LLC***APPENDIX G (CONFIDENTIAL) – COMPLIANCE WITH CORE PRINCIPLES****Compliance with Core Principles**

The Exchange has conducted a comprehensive analysis of the designated contract market core principles (“Core Principles”) as set forth in Part 38 of the Act.¹⁰⁷ The Core Principles relevant to the Contract are outlined and discussed in further detail below:

Core Principle 2 - Compliance with Rules and Impartial Access: The Exchange has adopted the Rulebook, which provides the requirements for accessing and trading on the Exchange. Pursuant to Chapter 3 of the Rulebook, Members must utilize the Exchange’s services in a responsible manner, comply with the rules of the Rulebook (“Rules”), cooperate with Exchange investigations, inquiries, audits, examinations and proceedings, and observe high standards of integrity, market conduct, commercial honor, fair dealing, and equitable principles of trade. Chapter 3 of the Rulebook also provides clear and transparent access criteria and requirements for Exchange Members. Trading the Contract will be subject to all the rules established in the Rulebook, which are aimed at enforcing market integrity and customer protection.

In particular, Chapter 5 of the Rulebook sets forth the Exchange’s Prohibited Transactions and Activities and specifically prescribes the methods by which Members trade contracts, including the Contract. Pursuant to Rule 3.2, the Exchange has the right to inspect Members and is required to provide information concerning its business, as well as contracts executed on the Exchange and in related markets. Chapter 9 of the Rulebook sets forth the Exchange’s Discipline and Rule Enforcement regime. Pursuant to Rule 9.2, each Member is required to cooperate with an Exchange investigation by making their books and records available to the Exchange. The Exchange’s Market Regulation Department performs trade practice surveillance, market surveillance, and real-time market monitoring to ensure that Members adhere to the Rules of the Exchange. The Market Surveillance Department reserves the authority to exercise its investigatory and enforcement power where potential rule violations are identified.

Core Principle 2 also stipulates that an exchange shall establish means to provide market participants with impartial access to the market. Chapter 3 of the Rulebook, and Rule 3.1 in particular, provides clear and transparent access criteria and requirements for Members. The

¹⁰⁷ CFTC Rule 40.2(a)(3)(v) requires a "concise explanation and analysis of the product and its compliance" with core principles. The rule also allows the DCM to incorporate information contained in documents supporting or relied upon to reach these conclusions. We note that we have relied significantly on the rulemaking record for for CFTC Industry Filing 22-022: Review and Public Comment Period of KalshiEx Proposed Congressional Control Contracts Under CFTC Regulation 40.11, available at <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7311>. As a result, we incorporate the comment file for CFTC Industry Filing 22-022 into this submission.

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Exchange will apply access criteria in an impartial manner, including through the application process described in Rule 3.1.

Core Principle 3 - Contract not Readily Susceptible to Manipulation:

Core Principle 3 and Rule 38.200 provide that a DCM shall not list for trading contracts that are readily susceptible to manipulation. The Exchange's marketplace and contracts, including this Contract, have been designed in accordance with this fundamental principle. The Exchange maintains various safeguards against outcome manipulation and other forms of manipulation, including, (i) automatic trade surveillance and suspicious behavior detection, (ii) Rulebook prohibition, Member certification, and notification, (iii) Member monitoring and know-your-customer verification, and (iv) sanctions. These safeguards render the Contract not readily susceptible to manipulation.

(i) **Automatic trade surveillance and suspicious behavior detection:** The Exchange's trade monitoring and market surveillance systems compute statistics using information from all trades that occur on the Exchange over a range of timeframes, ranging from per trade to the full history of trading activity. These statistics are geared towards identifying unusual trading activity and outlier behaviors. If the trade monitoring and market surveillance system identifies behavior deemed to be unusual, the Exchange's compliance personnel have the ability to investigate and determine applicable sanctions, including limits to or suspension of a Member's access to the Exchange.

(ii) **Rulebook prohibition, member certification and notification:** The Exchange's Rulebook includes various provisions that prohibit manipulative behaviors. As noted above in the discussion of Core Principle 2, the Exchange's Rulebook gives the Exchange the authority to investigate potential violations of its rules. Pursuant to Rule 3.2, the Exchange has the right to inspect Members' books and records, as well as contracts executed on the Exchange and in related markets. Pursuant to Rule 9.2, each member is required to cooperate with an Exchange investigation by making their books and records available to the Exchange for investigation. The Exchange's Market Regulation Department performs trade practice surveillance, market surveillance, and real-time market monitoring to ensure that Members adhere to the Exchange's rules. The Rulebook also imposes sanctions on Members who break rules. Potential penalties include fines, disgorgement, and revocation of membership in Kalshi. Only Members are allowed to trade on the Exchange, and the Exchange requires its Members to strictly comply with the Rulebook. Members cannot complete the account creation process and trade on the Exchange until they certify that they have read the Exchange's rules and agree to be bound by them.

In addition, the Exchange requires applicants for membership to represent and covenant that the applicant will not trade on any contract where they have access to material non-public

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information, may exert influence on the market outcome, or are an employee or affiliate of the Source Agency. In order to further reduce the potential for manipulation, the Exchange maintains a dedicated page on the trading portal that lists all the source agencies and their associated contracts, together with a warning that employees of those companies, persons with access to material non-public information, and persons with an ability to exert direct influence on the underlying of a contract are prohibited from trading on those contracts. This page is intended to serve as an effective means of raising Members' awareness of these rules and prohibitions, further reducing the potential for manipulation. Similarly, the Exchange places a prominent notice on each contract page that notifies Members of the prohibition on trading the Contract while employed by its Source Agency, trading the Contract on the basis of non-public information, and trading the Contract while having the ability to exert influence on the Contract's Market Outcome.

(iii) **Member monitoring and know-your-customer verification (“KYC”)**: The Exchange has a robust KYC process. The KYC process is an important tool that helps flag and uncover higher risk traders before they become Members of the platform. The Exchange's KYC process leverages technology to develop a clear and proper understanding of its members, and the various risks they may pose with respect to market integrity and fairness, including manipulation. During the application process, applicants are required to share personally identifiable information, such as their full legal name, identification number, date of birth, and address with the Exchange. Additionally, applicants are required to provide a government issued photo ID (passport, drivers license, etc.) that is used to validate the personally identifiable information shared by the applicant during the application process. Applicant information is run through a comprehensive set of databases that are actively compiled and maintained by an independent third party. The databases are utilized by the Exchange to identify applicants that are employees or affiliates of various governments and other agencies. Moreover, the databases can identify known close relatives and associates of such people as well. Applicants that are flagged go through enhanced due diligence, including manual review, as part of the onboarding process.

Additionally, as part of the KYC process, the Exchange runs applicants through adverse media databases. The adverse media dataset is a real-time structured data feed of companies and individuals subject to adverse media. Monitoring thousands of news sources, business and trade journals, in addition to local, regional and national newspapers, the adverse media feed isolates and highlights any entities or individuals subject to a range of adverse media. The Exchange utilizes the database to trigger enhanced due diligence, because applicants with adverse media may be more likely to engage in certain types of unlawful activity including market manipulation.

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The Exchange engages in active and continuing KYC checks. The KYC checks are initially performed upon application, and the Exchange then monitors its Members on an ongoing basis by running member information through the KYC databases. If material new information concerning an existing Member is at some point added to a database, the Exchange's system will flag the Member even if the cause for the flag was not extant at the time of the Member's application. That Member will then go through enhanced due diligence.

In addition, the Exchange shall engage in an additional three-step protection process.

- a. Before being allowed to participate, market participants must certify that they are not implicated by the prohibition list in Appendix B
- b. Before being allowed to participate, market participants must certify that they do not have access to material nonpublic information
- c. The Exchange's surveillance staff will conduct manual background checks and interviews with the top traders in a market, as well as randomly selected participants, to monitor and enforce the gating rules

(iv) **Sanctions:** Exchange Members must agree to the terms and conditions of the Exchange's Rulebook before being allowed to trade. As a result, Members are subject to disciplinary actions and fines for engaging in improper market conduct that is prohibited by the Exchange's Rulebook. In the event that suspicious trading activity is detected and results in an investigation initiated by the Exchange, market participants are required to provide the Exchange with information relevant to the scope of the investigation under Rule 3.2. Chapter 9 of the Exchange's Rulebook details the process for discipline and rule enforcement. Disciplinary action can range from a letter of warning to fines to referral to governmental authorities that can result in criminal prosecution.

In addition to these global policies and safeguards, there are a number of contract specific attributes and considerations that render the Contract not readily susceptible to manipulation. In addition to these global policies and safeguards, there are a number of contract specific attributes and considerations that render the Contract not readily susceptible to manipulation. Congress.gov is a division of the U.S. Library of Congress with multiple checks on publishing data. For example, given that Congress.gov is publicly available for any Congressional official or member of the public to access, discrepancies between whether an individual has or has not been made leader on Congress.gov (and their party membership) would likely be detected quickly, making manipulation of the website unlikely. In addition to the general availability of Congress.gov, the Contract relates to a high-profile event, which is the subject of immense media coverage and interest. Thus, any attempt to publish incorrect data would be quickly noticed and identified. The negative consequences that Library of Congress staff would likely face for

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publishing incorrect data in order to intentionally manipulate the market would also serve as a strong disincentive from attempting manipulation.

With regard to possible outcome manipulation, it is clear that the totality of U.S. Congressional elections are not readily susceptible to manipulation. The only groups that can directly affect the leadership decisions are the U.S. Senate and U.S. House of Representatives. Members of this group are extremely unlikely to attempt intentional manipulation of the leadership of their chambers to settle the Contract a certain way--the economic and political ramifications of which are far greater than the position limits on the Exchange. Instead of considering the potential outcome of the Contract on the Exchange, legislators involved with the confirmation are more likely to incorporate other factors into their decision-making process, such as political circumstances. The weight of these factors is much greater than any consideration of a market on the Exchange - thus manipulation for the sole purpose of influencing the outcome of the Contract is unlikely. The amount of media attention and financial reporting done on potential changes in leadership means that opportunistic attempts to manipulate reporting to affect prices is likely to be ignored given the amount of attention given to the subject. Members of Congress also have a sworn duty to represent their constituents and would not manipulate Congressional processes for private gain. Their finances are also heavily monitored and subject to public disclosure and scrutiny.

Moreover, election officials swear an oath to faithfully uphold the results of the elections. Tampering with federal elections is a serious federal crime and the consequences of violating would be quite severe. Vote counting is also supervised by trained members of both parties, whose incentive is to detect any deviation or error. In addition, any close election results in a recount, and therefore any manipulation by an individual or small group of individuals could reasonably be expected to be detected.

As further evidence, consider the history of political control contracts. University of Michigan professor Paul Rhode and Wake Forest professor Coleman Strumpf conducted a systematic review of the history of prediction markets both domestically and abroad, documenting their emergence back to “16th century Italy, 18th century Britain and Ireland, 19th century Canada and 20th century Australia and Singapore.”¹⁰⁸¹⁰⁹ In the United States, they were popular from the post-Civil War period until the Great Depression tarnished the image of Wall Street in the public imagination. They wrote,

Although vast sums of money were at stake, we are not aware of any evidence that the political process was seriously corrupted by the presence of a wagering market. This

¹⁰⁸ Paul Rhode and Coleman Strumpf. 2003. “Historical Prediction Markets: Wagering on Presidential Elections”.

¹⁰⁹ Paul Rhode and Coleman Strumpf. 2012. “The Long History of Political Betting Markets: An International Perspective.”

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analysis suggests many current concerns about the appropriateness of prediction markets are not well founded in the historical record.¹¹⁰

Today, election trading is alive and well in other democracies like the United Kingdom, without documented attempts at—let alone successful—manipulation. Any effort to coordinate votes for the sake of the Contract would take significant planning and coordination, and is unlikely to occur because none can know beforehand what the margin of victory is going to be. Accordingly, the organizers would have no way of knowing the size of the conspiracy they would need to orchestrate. Such an attempt would be implausible. Large-scale coordination of sufficient volume to affect an election of even a few hundred thousand voters (as exists in the smallest states or mid-size cities) would be too large to avoid scrutiny from market surveillance and counter-partisan mobilization. Nearly every commodity market can be altered if tens to hundreds of thousands of people all conspire simultaneously; however, it is nearly impossible to coordinate across tens of thousands of individuals without being visible. If this was a viable path, then highly motivated partisans would already attempt to do so and profit from the myriad ways they could profit by knowing the outcome of an election beforehand. The reason this type of criminal activity does not occur is that such a scheme would be readily detected.

One may also imagine that a coordinated group of individuals may conspire to manipulate market prices to give the false impression of candidate “momentum”, thus potentially harming the democratic process. This concern, too, is empirically implausible. Coleman and Strumpf in a later paper examined previous American political prediction markets and found that no previous effort at manipulation were capable of sustaining anything more than fleeting price movements. They wrote, “we find little evidence that political stock markets can be systematically manipulated beyond short time periods.”¹¹¹ Moreover, the markets examined were much smaller and thus even more prone to manipulation than a fully regulated, liquid market like a DCM. As a result, the probability of manipulation is implausible. Indeed, as George Mason University professor Robin Hanson and University of California at Santa Barbara professor Ryan Oprea found in one paper, one major reason why political contracts are rather invulnerable to manipulation attempts is that any attempt to manipulate prices induces informed counter-parties to enter on the other side of the market.¹¹² In fact, the greater the attempts to jazz up one side’s prices, the greater the returns to becoming an informed trader. As University of Michigan economist Justin Wolfers and Dartmouth economist Eric Zitzewitz write regarding previous political contracts, “none of these attempts at manipulation had a discernible effect on prices, except during a short transition phase.”¹¹³

¹¹⁰ Paul Rhode and Coleman Strumpf. 2003. “Historical Prediction Markets: Wagering on Presidential Elections”.

¹¹¹ Paul Rhode and Kolem Strumpf. 2005. “Manipulating Political Stock Markets: A Field Experiment and a Century of Observational Data.”

¹¹² Robin Hanson and Ryan Oprea. 2008. “A Manipulator Can Aid Prediction Market Accuracy.” *Economica*.

¹¹³ Justin Wolfers and Eric Zitzewitz. 2006. “Prediction Markets in Theory and Practice”.

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There are also legal protections against disrupting or pressuring the voting process of others. For example, the secret ballot is a guaranteed right in the vast majority of state constitutions, and statutorily protected in the rest.

The lack of substantiated attempts at manipulation of political control contracts by such methods is quite telling in the context of how much is already at stake in American elections. The economic impacts of elections themselves dwarf the value of Kalshi's contracts many, many times over. Likely trillions in stock value are deeply dependent on elections; entire sectors, firms, and places can be favored by a candidate for office; and almost every actor in the economy is directly affected by tax rates. The marginal addition of Kalshi's contract will not change whether or not elections are events of enormous consequence, and thus not increase anyone's incentive meaningfully to attempt manipulation of several hundred elections across the United States. American elections are not readily susceptible to manipulation, full stop, thanks to their decentralized nature, strong political norms, and laws protecting the vote. Elections, unlike many other reference markets or events that have CFTC-derivatives trading on them, are governed by multiple law enforcement agencies whose very existence is to prevent and detect election manipulation and fraud. This includes the Federal Election Commission, the federal Department of Justice, state election commissions, state Secretaries of State, and state ethics commissions. History has shown that these agencies are very good at their job.

Importantly, the fact that these contracts have already been *trading* on venues in the United States by Americans should demonstrate that they do not cause manipulation and that the markets are safe. In 2014, the Commission granted PredictIt, a new unregistered trading venue dedicated to election and political event contracts, a no-action letter. Since then, PredictIt has traded more than one billion shares.¹¹⁴ This information--that billions of dollars can be traded on contemporary exchange-traded political control contracts without creating manipulation concerns--was not available to the Commission the last time it considered similar event contracts in 2012.¹¹⁵ Election trading is also common over-the-counter in the United States among the largest financial institutions and high net worth individuals.¹¹⁶

Americans can also readily access cryptocurrency-based decentralized exchanges (DEXes) which offer political control markets on platforms such as Polymarket and Omen.^{117,118}

¹¹⁴ PredictIt.

<https://www.predictit.org/insight/aHR0cHM6Ly9hbmFseXNpcy5wcmVkaWN0aXQub3JnL3Bvc3QvMTg4NzQ3ODgwMDQzL2EtcHJlZGljdGFibGUtbmV3c2xldHRlci0xMTEwOSNtb2JpbGU=>

¹¹⁵ Nadex order. 2012. CFTC.

<https://www.cftc.gov/sites/default/files/idc/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>

¹¹⁶ Public Comment by Angelo Lisboa. Available at:

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69662>

¹¹⁷ Polymarket. <https://polymarket.com/market/will-gavin-newsom-be-governor-of-california-on-december-31-2021>

¹¹⁸ Omen.eth. <https://omen.eth.link/#/0x95b2271039b020aba31b933039e042b60b063800/finalize>

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Polymarket's markets on Congressional control have traded millions.¹¹⁹ In total, more than half of volume ever traded on Polymarket (north of \$50,000,000) were traded on election-related markets. These platforms are not registered with the Commission as Designated Contract Markets (DCMs), but frequently host such markets. Despite the CFTC's January 2022 order against Polymarket, it is still readily accessible by Americans via VPN. Betfair had more than \$500 million traded on the 2020 election.¹²⁰ There are no indications that the markets caused or induced an attempt to manipulate elections, let alone a successful manipulation.

With regards to possible price manipulation, in practice, there are few actors who hold meaningful non-public information that could affect the value of the Contract. Nonetheless, Kalshi is taking a large step to prohibit a large number of political actors from participating in the contract. Further, as part of the Exchange's KYC verification and monitoring system, the Exchange also cross-checks applicants against comprehensive databases. In particular, the Exchange will check whether any Members trading on this Contract are on databases of Politically Engaged Persons. The Exchange further cross checks applicants against databases of family members and close associates of Politically Engaged Persons. These checks help to further reduce the potential for trading violations and further increase the integrity of this Contract.

Core Principle 4 - Prevention of Market Disruption: Trading in the Contracts will be subject to the Rules of the Exchange, which include prohibitions on manipulation, price distortion, and disruption to the cash settlement process. Trading activity in the Contract will be subject to monitoring and surveillance by the Exchange's Market Surveillance Department. In particular, the Exchange's trade surveillance system monitors the trading on the Exchange to detect and prevent activities that threaten market integrity and market fairness including manipulation, price distortion, and disruptions of the settlement process. The Exchange also performs real-time market surveillance. The Exchange sets position limits, maintains both a trade practice and market surveillance program to monitor for market abuses, including manipulation, and has disciplinary procedures for violations of the Rulebook.

Core Principles 7 and 8 - Availability of General Information and Daily Publication of Trading Information: Core Principles 7 and 8, implemented by Regulations Sections Subsections 38.400, 38.401, 38.450, and 38.451, require a DCM to make available to the public accurate information regarding the contract terms and conditions, daily information on contracts such as settlement price, volume, open interest, and opening and closing ranges, the rules, regulations, and mechanisms for executing transactions on or through the facilities of the contract market, and the rules and specifications describing the operation of the contract market's electronic matching platform.

¹¹⁹ Polymarket. <https://polymarket.com/market/will-trump-win-the-2020-us-presidential-election>

¹²⁰ Seen at this link:

<https://www.actionnetwork.com/politics/2020-election-odds-trump-vs-biden-presidential-race-sportsbook-rovell>

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Rule 2.17 of the Rulebook sets forth the rules for publicizing information. The Rulebook and the specifications of each contract are made public on the Exchange website and remain accessible via the platform. The Exchange will post non-confidential materials associated with regulatory filings, including the Rulebook, at the time the Exchange submits such filings to the Commission. Consistent with Rule 2.17 of the Rulebook, the Exchange website will publish contract specifications, terms, and conditions, as well as daily trading volume and open interest for the Contract. Each contract has a dedicated “Market Page” on the Kalshi Exchange platform, which will contain the information described above as well as a link to the Underlying used to determine the Expiration Value of the Contract. Chapter 5 sets forth the rules, regulations and mechanisms for executing transactions, and the rules and specifications for Kalshi’s trading systems.

Core Principle 11 - Financial Integrity of Transactions: Each Member must be in good standing and in compliance with the Member eligibility standards set forth in Chapter 3 of the Rulebook. All contracts offered by the Exchange, including the Contract, are cleared through the Clearinghouse, a Derivatives Clearing Organization (“DCO”) registered with the CFTC and subject to all CFTC Regulations related thereto. The Exchange requires that all trading be fully cash collateralized. As a result, no margin or leverage is permitted, and accounts must be pre-funded. The protection of customer funds is monitored by the Exchange and ensured by the Clearinghouse as “Member Property.”

All Remaining Requirements: All remaining Core Principles are satisfied through operation of the Exchange’s Rules, processes, and policies applicable to the other contracts traded thereon. Nothing in this contract requires any change from current rules, policies, or operational processes.

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Introduction from Kalshi: The Better Markets letter does not represent the progressive view on election markets, and progressives have explicitly rebuked it. Many progressives, including (but hardly limited to) Data for Progress's [Sean McElwee](#), former Obama CEA chair [Jason Furman](#), former CFTC official and Senator Markey advisor [Justin Slaughter](#), Vox Future Perfect's [Dylan Matthews](#), and progressive civil rights attorney [Joel Wertheimer](#) also support these markets. Some of those (like Furman and McElwee) emphasized how election prediction markets contributed to decision-making in the White House and their efforts to help elect progressives, as well as how these markets would combat disinformation. With that said, we have included a line-by-line rebuttal of Better Markets's claims, along with claims by some other groups made today, the final day of the public comment process for Kalshi's proposal.

In this response, comments from Kalshi's previous proposal on Congressional control contracts are referenced, as they are material and relevant to Kalshi's current proposal.

Better Markets claim: *“Kalshi does not presently allow leveraged or margined trading on its platform, but it reserves the right to change this policy in the future, as it, of course, can change any of its other policies, procedures or statements...The Self-Certified Contract application also does not offer a description of how margin will be handled under the contract.”*

1. Kalshi does not offer leveraged or margined trading.
2. The implication that Kalshi may attempt to surprise the Commission with the introduction of leveraged trading (or another rule change), thus changing their calculus regarding the public interest of the proposed contract, is wrong. Kalshi has to submit to the Commission any proposal to allow leveraged trading, as it would be an alteration of our Rulebook. If the Commission thought that improper, it could block such a rule change under the relevant provisions of the law. Better Markets should be aware of CFTC Regulation 40, which lays out these procedures exactly (available here: <https://www.ecfr.gov/current/title-17/chapter-I/part-40>), in particular 40.5 and 40.6. They should not use a hypothetical future change in Rules (which the Commission could prevent) as a cudgel to stop these contracts.

Better Markets claim: *“Kalshi’s Self-Certified Contract fails to provide sufficient detail regarding several key issues surrounding the contract. As discussed above, Kalshi’s submission includes no specific details regarding the fee structure it would charge its users, stating only that users will be charged fees according to its own “Rulebook,” which Kalshi fails to include with its publicly available submission.”*

1. The Kalshi Rulebook has always been—since the Exchange’s launch in July 2021, been available to the public. The Rulebook is available here: https://kalshi-public-docs.s3.amazonaws.com/regulatory/rulebook/kalshi_rulebook_1.10.pdf and can be reached from the Kalshi homepage by clicking on the “Regulatory” button. Kalshi also has a dedicated page to highlight the fee schedule, which is available here: <https://kalshi.com/docs/kalshi-fee-schedule.pdf>. This page is also accessible from the Kalshi homepage by clicking on the Fee Schedule button. Kalshi has made all this information available to the Commission and to the public on day one.
2. In addition, the transparency of the fees is entirely immaterial to the question of whether the contract is permissible under the Commodity Exchange Act; this is why it was not included in the submission. Whether Kalshi charged low or high fees is a business decision, and not relevant to the question before us. This is why Kalshi’s Rulebook was not included; submissions by other exchanges for new products similarly do not include their Rulebooks or fee schedules or for other proposals unless that requires amendments to those documents.
 - a. In addition, Better Markets argue that the reason it is necessary to include this information is for the public’s consideration. However, Kalshi did not know, choose, or expect that the contract would be up for public comment prior to the vote of the Commission, and so would not have done so for that reason.

Better Markets claim: “...the Self-Certified Contract conspicuously omits any assessment of the actual impact of that trading activity, either on investors or those who may have attempted to use those contracts to, for example, hedge a risk. Finally, information regarding the Self-Certified Contract’s risk mitigation analysis and price-basing utility, as well as any additional considerations related to the Self-Certified Contract is not available to be reviewed for public comment for it is supposedly included in confidential appendices of Kalshi’s submission.”

1. This information is readily available in Kalshi’s public comment response; it is also available in Kalshi’s public comment response to the previous proposal, as well as Kalshi’s confidential appendices provided to the Commission for that previous proposal. This information was also provided in confidential appendices for the current submission. These assessments—drawing on private research, academic work, and market testimony—is more in-depth and research than anything yet provided to the Commission for a new contract. Whatever one’s qualms with this contract are, they are probably not, “Kalshi has not proposed that these contracts have hedging, price-basing, and other social value in detail.”
 - a. For convenience, [here](#) is the link to Kalshi’s public comment for this submission, [public comment](#) for its last submission, and the now public [appendices](#) for the previous submission.
2. To quickly summarize the major points:
 - a. **Hedging.** The financial press frequently reports on how elections (and changes in election polling, no less) affect the prices of financial assets, well before any laws by the new Congress have been enacted; thus, elections have an impact on expected cash flows.¹²³ Academic research consistently finds a link between movements in election prediction markets and financial assets, as well as between polls and financial assets.⁴ Investment banks also publish research to money managers (and the public, as the above mentions) that provides advice on how to hedge election risk in very specific ways. For example, JP Morgan Chase projected that a Democratic victory in 2020 would lead to a rally in ‘left-behind’ equities, such as “European cyclicals, value, China-exposed stocks and renewables” and portfolios should be adjusted accordingly. Even though the exact consequences of elections are not certain, political parties make sufficiently credible commitments to changing government policies in a manner that market participants currently believe are predictable enough—they’re already pricing in

¹ Noel Randewich. 2020. “S&P 500 futures rise as U.S. election suggests less regulatory risk.” Reuters.

² Myra P. Saefong. 2020. “Here’s how the U.S. presidential election could shake up the oil market.” Marketwatch.

³ Matthew Weaver. 2020. “Congressional elections could impact commodity prices most, expert says.” *Capital Press*.

⁴ Such as Snowberg, Zitzewitz, and Wolfers (2006); Zitzewitz and Wolfers (2016); and Jayachandran (2016). Available at: <https://www.frbsf.org/economic-research/publications/working-papers/2006/08/>, <https://www.brookings.edu/research/what-do-financial-markets-think-of-the-2016-election/>, <https://escholarship.org/content/qt25p4z52g/qt25p4z52g.pdf?t=krmnet>.

the risk and putting money on the line. Many commenters, ranging from managers of small businesses to major institutions, corroborated these points and testified to the value they would get from the contract.

- b. **Price-basing.** As discussed earlier, the market frequently reprices assets on the basis of changes in election expectations and election outcomes.⁵⁶⁷ The contracts can obviously be used to price MIAX's corporate tax futures and Kalshi's other political event markets related to bills passing, government shutdowns, and the debt ceiling. In 2012, more than two dozen economists signed a letter to the Commission supporting Nadex's submission that argued as much. Led by the late Nobel Laureate Kenneth Arrow in that 2012 letter, they wrote: "Political event futures facilitate price discovery in other asset markets. One of the findings of [our] research is that firms and industries are exposed to political and policy risk. Political event futures provide investors with a market-based assessment of outcome probabilities, which reduces investors' uncertainty when trading other assets."⁸ Many economists have done the same for Kalshi, including Nobel Laureate Robert J. Shiller, Phillip Tetlock, Justin Wolfers, Scott Sumner, Michael Abramowicz, Joseph Grundfest, Alex Tabarrok, Michael Gibbs, Jason Furman, David Pennock, Harry Crane, David Rothschild, Koleman Strumpf, Ryan Oprea, and others.⁹
- c. **Forecasting value.** The demand for accurate information surrounding elections is enormous – and valuable. This is why so many Americans turn to election models and updates offered by *FiveThirtyEight*, *The New York Times*, and *The Economist* around election time for advanced models that incorporate information. In a public comment, Jason Furman also emphasized the importance of election markets for policy making. Markets tend to be more accurate than any pundit or forecasting alternatives. The efficient, price-discovering nature of markets in a wide range of contexts is a well-substantiated finding in academic research. The collective wisdom of many people who have a direct monetary stake in the outcome results in a valuable price signal. Weather derivatives and agricultural futures are better at predicting the weather than meteorologists. Markets trading on the reproducibility of scientific research are better at discovering which papers will reproduce than experts, who do no better than chance. Most importantly, research studying IEM and PredictIt have confirmed that markets provide more accurate information than traditional forecasting methods.

⁵ Noel Randewich. 2020. "S&P 500 futures rise as U.S. election suggests less regulatory risk." Reuters.

⁶ Myra P. Saefong. 2020. "Here's how the U.S. presidential election could shake up the oil market." Marketwatch.

⁷ Matthew Weaver. 2020. "Congressional elections could impact commodity prices most, expert says." *Capital Press*.

⁸ Nadex public comment by Zitzewitz et al. Available at <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/ericzitzewitzltr020312.pdf>.

⁹ See public comments 70761, 69708, and 69735.

Comment No. 72723

Xavier Sottile, Kalshi

2023 Contract

ROA0002775

JA00653

Better Markets claim: *“Notwithstanding Kalshi’s representations, as deficient and incomplete as they are, Kalshi could possibly materially change any term, policy, or practice after receiving Commission approval of its contract.”*

1. Kalshi would have to self-certify any such change at a minimum. If the Commission thought that improper, it could block such a rule change under the relevant provisions of the law. Better Markets should be aware of CFTC Regulation 40, which lays out these procedures exactly (available here: <https://www.ecfr.gov/current/title-17/chapter-I/part-40>), in particular 40.5 and 40.6. They should not use a hypothetical future change in contract specifications (which the Commission could prevent) as a cudgel to stop these contracts.

Better Markets claim: *“The Kalshi contract involves gaming...The conclusion that the Kalshi contract, and the NADEX contract before it, involve or are similar to “gaming” follows from an analysis of both federal and state law. With respect to federal law, although ‘gaming’ is not defined in either the CEA or CFTC regulations, the Commission previously relied on the Unlawful Internet Gambling Enforcement Act in its prior finding that NADEX’s similar political event contracts constituted ‘gaming’ under the CEA and Commission Rule 40.11...Clearly, Kalshi’s proposed event contracts fall squarely within this definition—namely, ‘the staking or risking by any person of something of value upon the outcome of a contest of others’”*

Kalshi response:

- 1: Elections and political control are not games. Unlike games, in which the underlying activity has no inherent economic value apart from the money wagered on it, political control has an obvious and large economic impact, as it heavily influences expectations and the likelihood of public policy change. As Gregory Kuserk noted, unlike games, “Elections are events that are very important to the public, and there is a very strong public interest in having accurate data regarding elections.” Kalshi detailed as much in dozens of pages of evidence provided to the Commission, drawing on private and university research, policymaker and industry testimony, and the financial press. Many public comments by retail, industry, and academia have confirmed as much. Kalshi’s contracts do not involve gaming. It involves the partisan affiliation of the Speaker of the U.S. House of Representatives and the U.S. Senate’s President *pro tempore*, which are not determined through or relate to games of chance, or games of skill. Elections are not games, full stop. Indeed, the *Nadex Order* did not identify political elections themselves—the core of American democracy—as being a game.
 - Better Markets attempts to try and say elections are “gaming” because they involve a “contest of others”. However, the definition of gaming that they use—from Unlawful Internet Gambling Enforcement Act—made sure to specifically exempt Commission-regulated products.
- 2: Trading on Congressional control is not gaming. The Better Markets complaint cites the definition in the *Nadex Order* that defines gaming as the “the staking or risking by any person of something of value upon the outcome of a contest of others.” If taking a position on a Congressional control contract is equivalent to a ‘wager’ or ‘bet’ because it places money on an event’s outcome, that would imply that taking a position in any event contract is also equivalent to a ‘wager’ or ‘bet’. This is not true in law. While gambling is illegal in many states and interstate betting is prohibited, event contracts are legal in all jurisdictions. As former Commissioner Quintenz wrote: Gaming describes wagering money on an occurrence that has no inherent economic value itself other than the money wagered on its outcome. For instance, wagering money on roulette or blackjack should be considered gaming because there is no economic significance of the activity apart from

the wager itself. Speculation, on the contrary, is risking value where the underlying activity has economic consequences, which then means the speculative activity creates valuable societal and economic benefit from a price-discovery and risk transfer function for those exposed to the risk of that underlying activity. The relevant language of “involve, relate to, or reference” comes from Commission regulation 40.11. This language cannot be broader than the statutory language that is simply “involves”. By definition, if the regulation applied *more broadly* than the statute, it would per se violate the APA and be invalid.

- 3: The Application of the Special Rule is improper in this case: It would be improper to read that the provision of the CEA is referring to the contract as a whole when it would not make sense for the other prongs (e.g. assassination) to be possible *using* the contract. At the risk of bogging down this letter in further pages dedicated to just this question, we would direct the reader’s attention towards the letters from former CFTC general counsels Jonathan Marcus and Daniel Davis and the letter from Kalshi chief regulatory officer Elie Mishory. Better Markets’ claim regarding skill in poker is irrelevant to this analysis, as the Special Rule only applies to the *underlying event* (the partisan affiliation of the Speaker of the House and President Pro Tempore), and not the act of trading. Despite the two major parties both attempting to have control of the Speaker of the House and President Pro Tempore, the underlying event is not a game.

Better Markets claim: “...the legislative history of CEA Section 5c(c)(5)(C) makes clear that the relevant question for the Commission in determining whether a contract involves one of the activities enumerated in CEA Section 5c(c)(5)(C)(i) is whether the contract, considered as a whole, involves one of those activities”

1. Better Markets cites the *Nadex Order*, which merely repeats this assertion rather than providing analysis. The relevant part of the “legislative history” in the Congressional record appears to be a short dialogue between Senators saying that the purpose of the provision is to prevent contracts from being on the Kentucky Derby.¹⁰ This has no relation to whether 5c(c)(5)(C)(i) is referring to the contract as a whole or as one of its underlying activities.

¹⁰ Congressional Record—Senate, S5906 (July 15, 2010)

Better Markets claim: *“The Kalshi contract involves an activity that is unlawful under state law...Placing a bet or wager on the outcome of an election is civilly or criminally unlawful in well over a dozen states nationwide.”*

Kalshi response:

1. The Application of the Special Rule is improper in this case: Elections and political control are what is relevant to evaluate, which are nakedly not illegal under state law. It would be improper to read that the provision of the CEA is referring to the contract as a whole when it would not make sense for the other prongs (e.g. assassination) to be possible *using* the contract. Similarly, it is not possible to be in violation of state or federal law by trading a contract on a Commission-regulated board of trade. At the risk of bogging down this letter in further pages dedicated to just this question, we would direct the reader’s attention towards the letters from former CFTC general counsels Jonathan Marcus and Daniel Davis and the letter from Kalshi chief regulatory officer Elie Mishory. The Special Rule only applies to the *underlying event* (the partisan affiliation of the Speaker of the House and President Pro Tempore), and not the act of trading.
2. These laws do not refer, or apply, to CFTC-regulated products, and thus Kalshi’s product would not be “illegal under state or federal law” even when applying the “contract as a whole” standard. Federal law definitions of gaming, betting, and wagering carve out exemptions for CFTC-regulated products. Many states’ gaming provisions also include such exemptions. States’ gaming provisions are preempted explicitly as well by the Commodity Futures Modernization Act (“CFMA”). Even derivatives products that are excluded or exempted from CFTC regulation still preempt state gaming and bucket shop laws per the CFMA. It could not follow more plainly that CFTC-regulated derivatives have the same preemptive effect. Congress has repeatedly recognized that futures and other derivative contracts serve economic purposes and, therefore, state laws that purport to prohibit or regulate futures or derivative contracts (including gaming laws, which are specifically referenced in the CFMA as being preempted) do not violate the CEA and are preempted. Congress and the states understand that there is a critical distinction between betting and legitimate, federally recognized and regulated financial activity. Election contracts that are designed for price formation and hedging on a derivative exchange constitute legitimate financial activity.
 - a. In addition, an event contract on election outcomes is not the same as “gambling”. This is a critical distinction that Better Markets repeatedly conflates. As former Commissioner Quintez wrote in his *ErisX* statement, “there are qualitative and logical distinctions between speculation and betting. Whereas bettors participate in games of pure chance, whose sole purpose is to completely reward the winner and punish the loser for an outcome that would otherwise provide no economic utility (think roulette), speculators in the derivatives market

participate in non-chance driven outcomes that have price forming impacts upon which legitimate businesses can hedge their activities and cash flows.”

- b. If this interpretation is accurate, then generic anti-gambling laws by states would also prohibit other event contracts, including well established futures products. Clearly this is not the Commission’s interpretation of this provision of the Act, and in fact, *Nadex* is an outlier that is inconsistent with reams of Commission precedent, both preceding it and following it.

Better Markets claim: *“The proposed event contract is readily susceptible to manipulation... In her 2009 Harvard Law Review article “Prediction Markets and Law: A Skeptical Account,” Professor Rebecca Haw Allensworth detailed how bad actors might manipulate prediction markets: ‘Prediction markets are vulnerable to manipulation...First, they could profit by artificially lowering the trading price temporarily and purchasing shares to be sold at a higher price when the market returns to ‘normal’. Second, they could try to affect the informational value of the market. For example, a candidate’s supporter could purchase his shares at an inflated value, raising the perceived odds that he would win the election, and (hopefully) getting more voters to jump on the putative bandwagon...Given the use and abuse of social media in the gambling space and artificial intelligence (AI) in the political space, allowing gambling on U.S. elections will invite if not incentivize more interference, abuse, and misconduct as gamblers seek to effect political outcomes to maximize their winnings.”*

There are several issues with this line of reasoning:

1. Critically, this is a misread of the cited research.
 - a. Allensworth only cites one incident of successful manipulation, on an online exchange called TradeSports, referencing the case study on the incident conducted by Paul W. Rhode & Koleman S. Strumpf’s, “Manipulating Political Stock Markets: A Field Experiment and a Century of Observational Data.” However, Rhode and Strumpf conclude the opposite of Allensworth/Better Markets: that even the attempt to manipulate TradeSports’ small, unregulated market only succeeded in changing prices briefly, and conclude, “In the cases studied here, the speculative attack initially moved prices, but these changes were quickly undone and prices returned close to their previous levels. We find little evidence that political stock markets can be systematically manipulated beyond short time periods.”
 - b. The other study cited, by Deck et al., does find researchers successfully manipulate a small exchange of *their own creation, with made up assets, with a mere eight traders*. This clearly cannot be grounds to judge Kalshi’s proposed contract.
2. All research on this issue demonstrates how resilient such markets are to manipulation even in spite of no regulation.
 - a. Like Allensworth, Deck et al. even acknowledge this.¹¹ They wrote, “Wolfers and Zitsewitz (2004, p. 119) assert that ‘The profit motive has usually proven sufficient to ensure that attempts at manipulating these [prediction] markets were unsuccessful.’ Failed attempts at manipulating markets include political candidates betting on themselves (Wolfers and Leigh 2002) and bettors placing large wagers at horse races (Camerer 1998). Hansen, et al. (2004) did

¹¹ Deck, C., Lin, S., & Porter, D. (2010). Affecting policy by manipulating prediction markets: Experimental evidence. ESI Working Paper 10-17.

successfully manipulate election prediction markets, but the effects were short lived. In fact, Rhode and Strumph (2009, p. 37) provide an extensive discussion of attempts to manipulate political markets and conclude that ‘In almost every speculative attack, prices experienced measurable initial changes. However, these movements were quickly reversed and prices returned close to their previous levels.’” They go on to cite more experiments that showed resilience to manipulation, including that of Ryan Oprea and Robin Hanson, two supportive commenters.¹² They do not find any research that shows any successful manipulation that is not short-lived.

3. The research cited by Better Markets only focused on small-scale, generally illiquid, unregulated online prediction markets. A highly regulated market that can onboard institutional clients is even less likely to be a victim of a particular manipulator, as markets incentivize speculators to reverse any potential price impact a manipulator could have. Indeed, Hanson and Oprea found one major reason why political contracts are resistant to manipulation attempts is that any attempt to manipulate prices induces informed counter-parties to enter on the other side of the market. In fact, the greater the attempts to jack up one side’s prices, the greater the returns to becoming an informed trader. As University of Michigan economist Justin Wolfers and Dartmouth economist Eric Zitzewitz wrote regarding previous political contracts, “none of these attempts at manipulation had a discernible effect on prices, except during a short transition phase.” This finding was also noted by over two dozen economists in their 2012 Nadex letter and by many letters supporting Kalshi’s submission.
4. Such trading, even on a very large scale, is already happening. More than half a billion dollars was traded, for example, on the 2020 election by Betfair; such incentives already exist and have not impacted society at large. This is evidence, not speculation or conjecture.
5. The momentum theory, moreover, makes little sense in the first place. For one, momentum effects are symmetric: being down in the odds can be a fundraising tool as much as being up (people may like to support favorites, but they donate to underdogs). But it also does not make any sense in the context of the proposed Kalshi contract. The Kalshi contract regards the partisan identity of the President Pro Tempore and the Speaker of the House, *not* the result of individual races. Boosting the odds of Democrats winning the Senate from 55c to 60c does not motivate more or fewer people to show up, because they are not voting on a generic ballot for the Democrats or Republicans, they’re voting in individual races whose odds do not necessarily co-move with the national odds. This mechanism might be an argument against hosting a prediction market with no position limits and no surveillance on a minor election with lots of candidates, requiring people to make strategic decisions about preventing wasted votes, but that is not the contract before us.

¹² Hanson, R. and Oprea, R. “A Manipulator Can Aid Prediction Market Accuracy,” *Economica*, 2009, 76, 304-314.

6. The existence of social media or “artificial intelligence” (large language models) does not affect this analysis. False information is an issue in every democracy and in every time; in the *status quo*, there are more resources to discern truth (such as fact checkers and access to different, competing newspapers) than ever before in American history. Disinformation was much easier in the 1770s. The creation of false information only increases the returns to being an informed trader and proving that information false, as described in the paper by Hanson cited above.

Better Markets claim: *“...While Kalshi’s Self-Certified Contract is nominally limited to the change in partisan control of Congress, it can be anticipated that, if allowed, Kalshi and others would quickly offer similar contracts on all sorts of elections from the local level to the Presidency. Thus, the proposal, if approved or otherwise allowed to go into effect, would almost certainly usher in widespread betting on elections throughout America.”*

1. It is not true that approving this contract has implications for any contract, just as denying Nadex did not preclude the Commission from considering Kalshi now. The Commission cannot hold against Kalshi’s proposal that it could submit other proposals which are less worthy of being listed in the future to not list this one.

Better Markets claim: “With Kalshi allowing single contracts of \$100,000,000 and aggregate amounts at risk almost certain to be in the tens if not hundreds of billions of dollars, the incentive to interfere with and manipulate the political events are likely to prove overwhelming so some [sic] number of gamblers.”

It is important for the Commission to engage with the evidence on election integrity rather than speculate. The *Nadex Order*'s suggestion that voters could be incentivized to switch their votes, and thus harm election integrity, was outright speculative in 2012, and has since been disproven by PredictIt's success without any claim of, let alone proof of, election impropriety driven by those markets. PredictIt has traded more than a billion shares, all speculative. Today, election trading remains alive and well in other democracies like the United Kingdom, Australia, Ireland, and New Zealand, without documented attempts at—let alone successful—distortion of the electoral process.¹³ In foreign countries (which Americans use via virtual private networks as well), trading on American elections is even more popular than on their own, with Betfair logging more than a half billion in trades in 2020, without any such result or attempt. There is also major election trading on existing products that are traded on-exchange as well as products over-the-counter by institutions. Several commenters confirmed this, including Eric Crampton, the academic advisor to iPredict, a New Zealand based political prediction market:

What experience we had with iPredict suggests CFTC really doesn't have anything substantial to worry about in allowing contracts on political events. If anything, they heightened voter engagement. The CE [Chief Executive] of iPredict even featured on the nightly news during the election, giving the latest on election market prices. And for that brief period, whenever blowhard partisans insisted that some outcome was going to happen, people could just point to the iPredict price on the event and ask them why they thought that price was wrong, and whether they'd actually put their money where their mouth was. It was a remarkable era. iPredict inflation forecasts (they also had markets on inflation going out several years - it was so very good) wound up being noted in our Reserve Bank's Monetary Policy Statements. I desperately miss it. I envy the opportunities Americans could have if CFTC takes a sensible approach to regulation.¹⁴

Or Dustin Moskovitz, a co-founder of Facebook and founder of Asana:

Of course, it's important to validate that these contracts would not conflict with the public interest, and specifically the integrity of our elections. I am confident, however, they would not do so. Similar markets not only exist in many liberal democracies like the UK, but create a thriving scene that actually encourages voter participation and engagement.¹⁵

¹³ iPredict, the New Zealand political trading exchange, is no longer in operation, but was following the *Nadex Order*.

¹⁴ Public comment by Eric Crampton. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69738>.

¹⁵ Public comment by Dustin Moskovitz. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69716>.

References to other political markets without integrity issues were made by many commenters to the first submission, including, in addition to the above, Justin Xavier Geraghty, Upsolve founder Rohan Pavuluri, People's Policy Project founder Matt Bruenig, Zvi Mowshowitz, Roots of Progress founder Jason Crawford, macro analyst Sebastian Strauss, Quantitative Management Associates co-founder Margaret Stumpp, and New York University Law School professor Max Raskin, among others.

Likely trillions in stock value are deeply dependent on elections; entire sectors, firms, and places can be favored by a candidate for office; and almost every actor in the economy is directly affected by tax rates. Elections already have billions in consequences for retail, small businesses, and industry, dwarfing the value of even very large position limits, and yet attempts at manipulation are rare, and successful manipulation of Congressional control has never succeeded, thanks to the large, decentralized nature of elections, strong political norms, and laws protecting the vote. These contracts do not change, much less materially change the fact that individuals already have large stakes in election outcomes.

The only groups that can directly affect the leadership decisions are the U.S. Senate and U.S. House of Representatives. Members of these groups are extremely unlikely to attempt intentional manipulation of the leadership of their chambers merely to settle the contracts a certain way. Their finances are heavily monitored and subject to public disclosure and scrutiny, and Kalshi does not permit them, their close associates, or families to trade. Kalshi flags them and other politically exposed persons in the Know-Your-Customer authorization. Members of Congress also have a sworn duty to represent their constituents and have strong incentives not to manipulate electoral processes for private gain. Other related officials (like election officials, vote counters) also take such oaths and are heavily monitored because of the strong public interest in maintaining election integrity. Those actors also have a very marginal impact on the outcome (e.g. a vote counter in a particular precinct). This should clarify any claim that this could de-legitimize elections internal to Congress itself.

As further evidence, consider the history of political control contracts. University of Michigan professor Paul Rhode and Wake Forest professor Koleman Strumpf conducted a systematic review of the history of prediction markets both domestically and abroad, documenting their emergence back to "16th century Italy, 18th century Britain and Ireland, 19th century Canada and 20th century Australia and Singapore."¹⁶¹⁷ In the United States, they were popular from the post-Civil War period until the Great Depression tarnished the image of Wall Street in the public imagination. They wrote,

¹⁶ Paul Rhode and Koleman Strumpf. 2012. "The Long History of Political Betting Markets: An International Perspective." Strumpf also was a signatory to a supportive public comment. *See* Public comment 69735. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69735&SearchText>

¹⁷ Paul Rhode and Koleman Strumpf. 2003. "Historical Prediction Markets: Wagering on Presidential Elections".

Although vast sums of money were at stake, we are not aware of any evidence that the political process was seriously corrupted by the presence of a wagering market. This analysis suggests many current concerns about the appropriateness of prediction markets are not well founded in the historical record.¹⁸

As with other contracts that deal with publicly important information, the integrity of the decision-making process by political bodies like the Federal Open Market Committee (which could conceivably be impacted by the existence of federal funds rate futures) has not been eroded despite contracts that trade enormous volumes on their impact. This is no different.

In fact, Kalshi's contract will move this behavior into the light where it can be monitored by the Commission. Americans readily access offshore platforms using a virtual private network such as Betfair.¹⁹ Betfair had more than \$500 million traded on the 2020 election.²⁰ These platforms are not registered with the Commission as DCMs, but frequently host such markets. There are no indications that the markets caused or induced an attempt to manipulate elections, let alone a successful manipulation. However, if the Commission is concerned that election markets could nevertheless create election integrity threats, it is imperative to shift trading to an exchange compliant with the Core Principles, with insider trading protections, surveillance, and KYC. In this way, among others, approving the contracts would improve, not harm, election integrity and the perception of it.

¹⁸ Paul Rhode and Coleman Strumpf. 2003. "Historical Prediction Markets: Wagering on Presidential Elections".

¹⁹ Comment letter by policy commentator Matt Bruenig. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69670>.

²⁰ See end of document.

Better Markets claim: *“Kalshi’s submission (or at least the part available to the public) does not explain how it will identify and eliminate manipulation risks. Given the many ways one could conceivably influence or manipulate a prediction market to their advantage, the Commission should not allow the adoption of political event contracts as Kalshi proposes.”*

Kalshi at length describes in its submission to the Commission and its public comments how unlikely and near impossible election manipulation is; the standard for Core Principle 3 is that contracts not be readily susceptible to manipulation, and the American electoral system is plainly less susceptible to manipulation than oil futures are. That being said, Kalshi is deeply committed to making sure that such attempts are never even attempted, and to that end—as detailed in its submission and comments—has taken major steps to prevent such behavior. For these contracts, Kalshi employs Know-Your-Customer authorization and would prevent trading by Politically Exposed Persons, including campaigns and PACs, as well as individuals’ close associates and family. It also has identified a long list of political actors who are specifically prohibited from trading. The Exchange has rules that prohibit manipulative trading, and the Exchange performs surveillance to detect manipulation. This serves as a deterrent to attempts to manipulate the market via manipulative trading. In addition, the Exchange’s rules also prohibit trading on non-public information, and the Exchange performs surveillance to detect violations of this rule. The Exchange is also adopting contract specific gating rules that further buttress this rule. Specifically:

- a. Before being allowed to participate, market participants must certify that they are not implicated by the prohibition list in Appendix B
- b. Before being allowed to participate, market participants must certify that they do not have access to material nonpublic information
- c. The Exchange’s surveillance staff will conduct manual background checks and interviews with the top traders in a market, as well as randomly selected participants, to monitor and enforce the gating rules

The Exchange will be surveilling its market for any sign of trading that is indicative of manipulative or fraudulent behavior. The Commission will have all of the necessary data to do the same, should it so wish.

Better Markets claim: “...unlike non-profit prediction markets, Kalshi would face significant commercial pressure to extract wealth from its users through high transaction, commission, withdrawal, and other fees.”

1. This is again immaterial as to whether or not the contract is compliant with the Act and the Core Principles.
2. Kalshi would not have a monopoly on such a contract and would presumably compete with other registered contract markets, which would reduce the ability of any individual exchange, including Kalshi’s, from setting abusive fees, which would in fact *increase* competition to the benefit of market participants.
3. Kalshi’s fee schedule is on its website and is plainly reasonable.

Better Markets claim: *“Kalshi’s proposed contract would redirect capital from productive uses into highly speculative markets...Such markets prey on unwary traders and typically serve to enrich the few at the expense of the many.”*

This is again immaterial to whether the contract complies with the Act and the Core Principles.

Better Markets claim: *“CFTC Regulation 40.11(a)(2) includes a very important catch-all provision...betting via event contracts on where the next school shooting will be or how many school children will be murdered in the next school shooting are not enumerated and therefore it could be argued not prohibited...Regarding Kalshi’s Self-Certified Contract, in addition to being unlawful under a number of state and federal laws and prohibited gaming (either directly or because it “involves” and “relates to” gaming), it should also be prohibited because it is similar to gaming and therefore should be rejected as contrary to the public interest.”*

1. This is a ludicrous example: obviously event contracts on the next school shooting would be captured by the prong that includes activity illegal under state or federal law. It is covered by 40.11 in the *status quo*.
2. Kalshi’s proposed contracts, for the reasons described earlier in this response, do not involve, relate, or refer to gaming or activity that is illegal under state or federal law. For the same reasons, they are not “similar” to such activity or any of the enumerated activities in 40.11. Better Markets does not describe why they are ‘similar’ to the enumerated activities; they merely argue that they are, and those arguments are wrong as detailed in earlier responses.

Better Markets claim: *“Congress did not intend for the CFTC to police elections...The prospect of the CFTC assuming the role of an "election cop" raises valid concerns about the misalignment of that role with the CFTC's mandate and with the original intent and objectives set forth by Congress.”*

This again does not address whether or not the contract complies with the Act and the Core Principles. That being said, Kalshi firmly agrees that Congress did not intend for the CFTC to be an “election cop” *per se* like the Federal Election Commission or Department of Justice; this is immaterial and does not preclude the listing of an event contract on such a matter. They also did not intend for the CFTC to be a “GDP data cop” or a “Fed cop” or a “cattle fraud cop” even though it did give the CFTC the authority of monitoring contracts on the outcomes of Federal Reserve decisions and GDP data (even when the Federal Reserve does have credible allegations of insider trading, as it has had in the last three years).

There is no reason for the Commission to believe it will be responsible for policing attempts at or successful election fraud. No more and no less than the CFTC is responsible for any other type of underlying fraud that has impacts on a contract. Earlier this year, there were two individuals who were arrested for attempting to destroy power stations with the ultimate goal of destroying the city of Baltimore.²¹ If successful, the sabotage would have impacted electricity prices significantly. Is the CFTC “obligated . . . to investigate or otherwise become involved in the” prosecution of these two individuals? Is the CFTC “obligated . . . to investigate or otherwise become involved in the” protecting of America’s power grid? OPEC+ impacts the prices of global oil, including the futures markets that the CFTC regulates. Is the CFTC therefore “obligated . . . to investigate or otherwise become involved in the” OPEC+ meetings, a cartel that is obviously manipulating prices? Is the CFTC “obligated . . . to investigate or otherwise become involved in the determination of corporate dividends that underlie the CME’s contract? The answer to all of these is that the CFTC will get involved to the extent that it is necessary for it to administer and enforce the CEA. The CFTC does not, in any of these cases, assume the role of the “cop on the beat”. This application here is no different.

Election manipulation is a crime.²² There are law enforcement agencies who police elections, and elections are policed much more effectively than other markets that have CFTC derivative products trading on them. The Commission is not the only “cop on the beat” with regard to election fraud. Elections, unlike many other reference markets or events that have CFTC-derivatives trading on them, are governed by multiple law enforcement agencies whose very existence is to prevent and detect election manipulation and fraud. This includes the Federal Election Commission, the federal Department of Justice, state election commissions, state Secretaries of State, and state ethics commissions. History has shown that these agencies are very

²¹ <https://abc7chicago.com/power-grid-attack-sarah-clendaniel-brandon-russell-baltimore-plot/12777303/>.

²² <https://www.fbi.gov/how-we-can-help-you/safety-resources/scams-and-safety/common-scams-and-crimes/election-crimes-and-security#:~:text=Intentionally%20deceiving%20qualified%20voters%20to,%2Fhow%2Dto%2Dvote.>

good at their job. The other day, the CFTC brought an enforcement charge against Alexander Mashinsky and Celsius Network, LLC, where the CFTC acknowledged the role that was played by both the SEC and the U.S. Attorney's Office for the Southern District of New York.²³ Similarly, Cody Easterday committed fraud that was discovered by Tyson foods and prosecuted by the Department of Justice. The CFTC *also* charged Easterday, presumably after cooperating with the relevant criminal authorities. These are two examples of many. The CFTC is well-versed in cooperating with the relevant law enforcement agencies, be it the FBI or DOJ or any other relevant federal or state authority. There is no reason to assume that the CFTC would somehow lose that competency in this case.

²³ <https://www.cftc.gov/PressRoom/PressReleases/8749-23>

Better Markets claim: *“The unpredictability of the specific, concrete economic consequences of an election (or change in partisan control of Congress) means that the political event contracts cannot reasonably be expected to be used for hedging purposes. The political event contracts’ prices could not form the basis for the pricing of a commercial transaction involving a physical commodity, financial asset or service, which demonstrates that the political event contracts have no price-basing utility.”*

The financial press frequently reports on how elections (and changes in election polling, no less) affect the prices of financial assets, well before any laws by the new Congress have been enacted.²⁴²⁵²⁶ Academic research consistently finds a link between movements in election prediction markets and financial assets, as well as between polls and financial assets.²⁷ Even though the exact consequences of elections are not certain, political parties make sufficiently credible commitments to changing government policies in a manner that market participants currently believe are predictable enough—they’re already pricing in the risk and putting money on the line.

Investment banks routinely provide clients with advice on hedging through their private wealth divisions. This was described in a comment letter provided by a Managing Director of JPMorgan Chase. He wrote,

At JPMorgan, election risk is one of the largest risks our clients face, and they frequently engage us proactively on how to minimize it (hedge it, in other words). We work with and advise our clients on how to avoid that risk in their portfolios, especially when a client’s cash flows or investments are very politically sensitive (for example, those in the coal industry are very concerned regarding election outcomes and policy expectations).

Since clients have different risk profiles, we do extensive research to fine-tune how these risks add up in our clients’ positions. Our division employs a team of economists, at service to our partners, whose role in election years is heavily to research election probabilities as well as the impact election outcomes will have on equities and other investment products. We frequently host discussions with experts and clients on the relevant risks (including one coming up this week!) and publish research for both clients and the public.²⁸

²⁴ Noel Randewich. 2020. “S&P 500 futures rise as U.S. election suggests less regulatory risk.” Reuters.

²⁵ Myra P. Saefong. 2020. “Here’s how the U.S. presidential election could shake up the oil market.” Marketwatch.

²⁶ Matthew Weaver. 2020. “Congressional elections could impact commodity prices most, expert says.” *Capital Press*.

²⁷ Such as Snowberg, Zitzewitz, and Wolfers (2006); Zitzewitz and Wolfers (2016); and Jayachandran (2016).

Available at: <https://www.frbsf.org/economic-research/publications/working-papers/2006/08/>,

<https://www.brookings.edu/research/what-do-financial-markets-think-of-the-2016-election/>,

<https://escholarship.org/content/qt25p4z52g/qt25p4z52g.pdf?t=krnmet>.

²⁸ Public comment by Angelo Lisboa. Available at

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69666>.

Investment banks also publish research to money managers (and the public, as the above mentions) that provides advice on how to hedge election risk in very specific ways. For example, JP Morgan Chase projected that a Democratic victory in 2020 would lead to a rally in ‘left-behind’ equities, such as “European cyclical, value, China-exposed stocks and renewables” and portfolios should be adjusted accordingly.²⁹

Many other comment letters by retail traders (Raphael Crawford-Marks, Scott Supak, Jacob Colbert, Jacob Faircloth, Andrew Karas, Joseph Turano, among many others), industry leaders (Jorge Paulo Lemann, Christopher Helmeyer, Ron Conway, Seth Weinstein, among many others) and owners of politically sensitive businesses, (Continental Grain Company, Klarna, Greenwork, Upsolve, among many others) agreed and specifically discussed personal hedging use cases.³⁰ Consider the comment by Scott Supak:

In the more immediate political future, the hedging benefits are obvious: since I’m no longer employed through my union, my wife no longer has health coverage through my union, so we must purchase (very expensive) health insurance from the marketplace. When it seems that Republicans are likely to take control, I can invest in that possibility, and hedge against the risk that her health insurance premiums will go up (or that the subsidy will get smaller, or that her ability to purchase insurance at all is taken away completely).³¹

Or the comment by Greg Sirotek, the co-founder and CEO of Moneytree Power, a startup dedicated to installing solar power:

Congress has an incredible influence over the future of the zero-carbon energy industry, particularly the solar industry...Given the respective differences in the two parties’ positions on the importance of climate change mitigation, renewable energy development and the deficit, the risk profiles depending on which party is in power is vast. An event contract which pays out on the basis of Congressional control would allow our business to manage this previously unhedged risk.³²

Lemann, a founder at 3G Capital (one of the world’s largest investment firms) and a Board member of firms like AB-InBev and Kraft Heinz (some of the largest participants in traditional agricultural and metals futures), wrote:

²⁹ Ksenia Galouchko. 2020. “JPMorgan Says Biden Victory Could Mark a Stock Market Shift.” Bloomberg.

³⁰ Public comments 69668, 69715, 69667, 69683, 69678, 69619, 69684, 69717, 69714, 69718, 69727, 69707, 69677, 69655.

³¹ Public comment by Scott Supak. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69715>

³² Public comment by Greg Sirotek. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70751>.

These statements [the *Nadex Order's* claims that there are no hedging or price basing use cases for elections] are inconsistent with the preponderance of the academic research on the subject and is inconsistent with the actual experience of anyone who has ever operated a business in or with the United States or traded on the global commodity markets. Experience and empirical observation show that elections have consequences, and these consequences directly create risk that can be hedged, and are factored into pricing commodities, financial assets, and services.³³

Hehmeyer, former Chair of the National Futures Association and Board Member of the Futures Industry Association, added that many are affected *regardless of policy outcomes*:

For example, media personalities and companies face risk from Congressional control and elections. Early professionals hoping to work on Capitol Hill know there are far more positions available if their preferred party is victorious, as there are more Congressional offices and committee positions for them to staff. A consultancy that specializes in specific topic areas (for example, a green energy consultancy) may know the demand for their services will decline in anticipation that their issue of expertise is less likely to be operative under a split Congress. These risks occur regardless of the legislation that actually passes. There are billions of dollars at risk surrounding the outcome of Congressional control and elections. These risks can reasonably be expected to be managed through this contract on Congressional control.³⁴

Although some commenters claimed election outcomes aren't predictable enough to be a useful hedge, that in no way contradicts or even diminishes those who say the opposite. *At most*, those commenters don't see hedging utility for themselves. But they cannot credibly say, especially given the comment file, that all the people who identify how they would use the contracts for hedging and managing their risk are mistaken or deficient in their ability to recognize risk and potential tools to manage or mitigate that risk. It would be arbitrary for the Commission to listen only to those who assert that there is no hedging use case for anyone when there are many others who state that they *would* use the product for themselves or their business.

As noted by Hehmeyer, there is sufficient impact from elections themselves, independent of the policy implications of political control, to not only justify these markets' economic utility but to make them valuable. In addition, markets already believe that the policy implications of elections themselves are sufficiently meaningful so as to be worth repricing assets, suggesting that they are predictable *enough*. Elections have vast consequences, which directly impact the likelihood of

³³ Public comment by Jorge Paulo Lemann. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69684>.

³⁴ Public comment by Christopher Hehmeyer. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69717&SearchText=christopher>.

events happening or not happening (such as a bill being passed). While it is true that there is some uncertainty about the precise implementation of any given law by a new Congress (e.g., what exactly would the size of the stimulus checks be, what exactly would the new tax rate be), changes in probabilities are more than sufficient for hedging purposes. In addition, once the specifics of a policy risk have been announced (like the text of a bill), it's practically impossible to hedge because of the high cost now that the probability of the event has increased. It's important for a potential hedger to hedge in advance of the specifics of their risks being announced.

Changes in *general risk* also can provide a strong hedging need as opposed to the changes in risk of a specific outcome. If one party is in complete control of Congress, there is likely to be a change in *general risk* on carbon-based energy products and industries and an opposite change in *general risk* on renewable energy products and industries. While the specific policies implemented may be hard to know in advance, that change in *general risk* has been discussed at length in comment letters and is hedged extensively by larger institutions through complex products.³⁵

Consider a concrete example of probabilistic change from the bond markets. Ten percent of the catastrophe bond market is in "parametric triggers," which means the bond pays out if certain meteorological triggers are met. The bond issuer does not know for certain whether the storm that meets the threshold will cause mass flooding, power outages and property damage (and conversely, it's possible that such damages could occur with a storm that does not meet the trigger thresholds) yet they use the bond to hedge nonetheless, because other features of the bond (hedging wind speed, namely) are more important to them than eliminating basis risk. Moreover, even if a wheat farmer buys a contract that pays out if the price of wheat falls below a certain threshold, there is still some uncertainty as to whether that event will harm them. It's possible that (a) wheat falls below a certain threshold because weather conditions are so great that there was a bumper crop and that the increase in their supply offset the loss in price, or (b) that the national price does not perfectly correlate with the local price they received—but they can use the product nevertheless.

It is not Better Markets' place, nor is it the Commission's place, to tell market participants how they are supposed to assess their own risks and how they would hedge them.

³⁵ Public comment by Angelo Lisboa. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69666>.

Better Markets claim: *“Moreover, the burden is on Kalshi to also specify why and exactly how the alleged hedging benefits of the proposed contract cannot be adequately addressed by existing hedging instruments. Kalshi’s submission fails to carry this burden. More specifically, Kalshi has failed to demonstrate why existing hedging mechanisms more tailored to the particularized risks a hedger arguably faces — such as a sector-specific fund, for example — are inferior to Kalshi’s proposed contract. Ultimately, political risk itself must be disaggregated into other, more specific, concrete risks. And to the extent that any more specific risks flow from the change in control of a congressional chamber, they are more appropriately hedged by instruments other than the Self-Certified Contract.*

That is not a burden Kalshi has to prove in order for the contract to be listed. The standard that a derivative product be *unique* in its hedging value is not a norm, law, or regulation. Even so, Kalshi passes it.

This argument can be taken to imply two different things, either that the other products are linked directly on the same risks that the contracts would be used for hedging, or that market participants can reasonably approximate the Contract’s hedging utility via a melange of other instruments.

Assuming the former, the answer is yes, there are risks that cannot be currently hedged. First, as noted by Hehmeyer and other commenters, and in the Exchange’s submission, there are significant direct, non-policy related economic risks, such as the risks imposed by political outcomes on the fortunes of media personalities, media consultants, and others with connections and ties to the party in power. These risks cannot be otherwise hedged by traditional products.

As discussed earlier, changes in general risk that a certain Congress could pose to various industries can be discerned well in advance of knowledge of the particular policies that may be implemented by that Congress and provide just as valid a hedging rationale. This difference results from the time horizon between the election cycle and the implementation of a new Congress’ specific legislative agenda or its potential responses to current events. For example, following the election of Republicans into Congress in 2016, many publications speculated that trade policy would become more restrictive; however, it was not known if this would come in the form of new trade deals, re-negotiating existing trade agreements, new tariffs (and if so, on what goods and at what level), international lawsuits, and more. Another event contract or future on taxes or public policy would not have been very helpful. However, the risk of a more restrictive policy was there because of who would win the election, exactly what Kalshi’s contracts allow traders to hedge.

Another example is new legislation that would burden a market participant. Once the legislation draft is released, the impact will begin to be felt immediately (on assets, cash flows, and

partnerships as market participants price in risk), making a hedge useless; the downside risk has already had much of its effect. Markets are forward looking, and hedging products should reflect that. Even just a statement by a politician can be very damaging for firms.³⁶

Additionally, a single market participant may face myriad risks from elections. Many firms and individuals are negatively affected by a suite of a party's policies, and thus wish to hedge the many different changes in risk through a single contract. For example, an oil company may wish to hedge the risk that a new Democratic government will come into office, because that government could not only impose new regulations on them but also change the composition of existing regulatory bodies and increase their labor costs (through raising the minimum wage, supporting unionization, or mandating greater health care benefits for employees). Only Kalshi's proposal lets them hedge the risk they actually face: Democratic government.

If the question is asking instead whether market participants can reasonably approximate the Contract's hedging utility via a melange of other instruments, the answer is they cannot. Many retail and small business market participants do not have access to these other instruments, and the inherent friction and transaction costs in arranging these types of complex proxy plays is prohibitive. It seems unlikely that the Commission would determine it in the public interest to solely rely on these tools that are inaccessible to many of the market participants who need risk management tools most. Additionally, the effectiveness of these baskets and combination of instruments to hedge the risk from political control is considerably less than a contract directly on political control.

Importantly, the question implies that its answer matters, but does not explain why it would. A reasonable inference is that the Commission is saying no new method of hedging a risk should be permitted if there are other existing methods of hedging that risk. Nowhere in the CEA or the Commission's Regulations is there such a standard. The Exchange hopes this is not the Commission's view, as it has not been the Exchange's experience when engaging with the Commission on prior contracts. For example, should the Commission say "farmers can buy crop insurance therefore they should not have access to agricultural futures products"?

Furthermore, such an interpretation would be highly anti-competitive. Such an interpretation would mean that if one firm offers a contract on an event or a commodity, that no challenger should enter the market with a similar but different product to compete with it. In fact, such an interpretation would consistently punish novel or innovative products – in many cases, it is possible to construct a hedge using existing products, and attempting to do so might be expensive or incur excess basis risk. The fact that election risk has implications for other assets is, in fact, much of the justification *for* the contract's hedging utility and would work in concert with such

³⁶ White, Spencer. "Hillary Clinton Blog Post Hits Valeant Stock For 9% Loss Without Revealing New Policy." Yahoo Finance. 2016.

assets. Many similar and competing products are listed by different exchanges in order to promote a vibrant and competitive marketplace for hedgers. This is also an important component of the contract's price discovery utility, discussed in a later question.

Such an interpretation would also curtail innovation. Innovation often happens through iterating on already successful products and ideas. As in the earlier example, the existence of insurance products would have inhibited the creation of futures. Innovation often requires creating new, and sometimes flawed, products in order to try and optimize use cases for market participants. Hedgers benefit when many exchanges are launching many different products to try and tailor to their needs; they suffer when the government limits their options. It's in the public interest for such innovation to occur, and for that to happen, the Commission should not take the view that this product should not be listed because it purportedly can be hedged through other means.

OTHER RESPONSES FROM LAST MINUTE COMMENTS

In a letter by Congressmen Raskin and Sarbanes, they argue: "...there is the potential for an event contract like Kalshi's to increase incidents of terrorism or assassination, two of the categories that are expressly defined as 'contrary to public interest.'"

Threats of violence against elected officials or others involved in the political process are destructive to democratic integrity. Kalshi has taken great care to make sure that its contract is first, not readily susceptible to manipulation, which would incentive such behavior; and second, that this has not occurred with other, similar contracts (e.g. offshore trading on American elections has not caused this behavior, and federal funds futures contracts have not created threats of violence against Federal Open Market Committee members). This impact is also speculative enough that it is not part of the activity underlying the contract, and should not be considered to mean that the contract triggers 40.11 by means of involving terrorism or assassination.

A letter by the Center for American Progress claims that bettors on Betfair "fueled the fire" of election denial in 2020. This is an incorrect reading of their citation, a single press article which discusses how Trump supporters were doing the opposite: betting in favor of Trump *because* they believed he would be President, not trying to make him President because they had traded. Kalshi's Contract will also only be on the outcomes of Congressional control, which individuals have near-zero impact on.

United States Senate

WASHINGTON, DC 20510

August 2, 2023

The Honorable Rostin Behnam
Commodity Futures Trading Commission
1155 21st St NW
Washington, DC 20581

Dear Chairman Rostin Behnam,

We are writing regarding the Commodity Futures Trading Commission's (CFTC) review of KalshiEX, LLC's (Kalshi) Congressional control event contract submitted to the CFTC on June 12, 2023.

The CFTC recently announced its review of contracts self-certified by KalshiEX, LLC (Kalshi) on which political party will be in control of each chamber of the U.S. Congress, under CFTC Regulation 40.11(c).¹ The CFTC has to make a determination with respect to the contracts, a decision which could effectively allow legal gambling on our elections. This is a clear threat to our democracy and elections. We urge the CFTC to reject Kalshi's Congressional Contracts on which political party will be in control of each chamber of the U.S. Congress.

CFTC regulations prohibit event contracts that "involve, relate to, or reference... gaming... an activity that is unlawful under any State or Federal law... or other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest."² Kalshi's proposal closely resembles gaming;³ placing a bet or wager on the outcome of an election is civilly or criminally unlawful in well over a dozen states nationwide,⁴ and establishing a large for-profit market on election outcomes is decidedly contrary to the public interest.

The CFTC has never allowed a for-profit venture to operate a political event contract, nor has the agency permitted any entity to operate a political event contract of such scale. Establishing a large scale, for-profit political event betting market in the United States by approving Kalshi's requested contracts, would profoundly undermine the sanctity and democratic value of elections. Introducing financial incentives into the elections process fundamentally changes the motivations behind each vote, potentially replacing political convictions with financial calculations.

For example, billionaires could expand their already outsized influence on politics by wagering extraordinary bets while simultaneously contributing to a specific candidate or party. There are strong ethics concerns as political insiders privy to non-public information could wield their inside information to profit at voters' expense. Lastly, these bets could sway the outcome of our elections, undermining the voices of voters. If citizens believe that the democratic process is being influenced by those with financial stakes, it may further exacerbate the disenfranchisement and distrust of voters already facing our nation.

¹ <https://www.cftc.gov/PressRoom/PressReleases/8728-23>

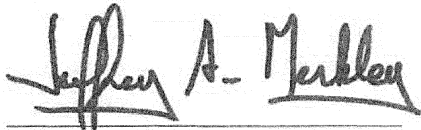
² 17 CFR § 40.11

³ The Unlawful Internet Gambling Enforcement Act defines the terms "bet or wager" as "the staking or risking by any person of something of value upon the outcome of a contest of others, a sporting event, or a game subject to chance, upon an agreement or understanding that the person or another person will receive something of value in the event of a certain outcome."

⁴ https://bettermarkets.org/wp-content/uploads/2022/09/Better_Markets_Comment_Letter_KalshiEX.pdf

There is no doubt that the mass commodification of our democratic process would raise widespread concerns about the integrity of our electoral process. Such an outcome is in clear conflict with the public interest and would undermine confidence in our political process -- we urge the CFTC to deny Kalshi's proposal.

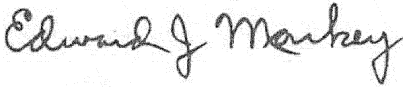
Sincerely,




Jeffrey A. Merkley
United States Senator



Sheldon Whitehouse
United States Senator



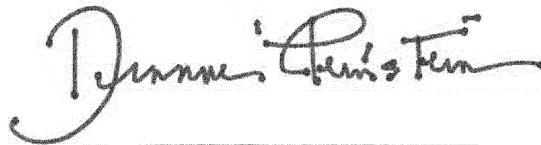
Edward J. Markey
United States Senator



Elizabeth Warren
United States Senator



Chris Van Hollen
United States Senator



Dianne Feinstein
United States Senator

United States Senate

WASHINGTON, DC 20510

August 8, 2023

Chairman Rostin Behnam
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Dear Chair Behnam:

I write to express concern about KalshiEX LLC's submission of contracts to allow for legal gambling on the outcome of U.S. elections.

Our free and fair elections are essential to public confidence in our democracy, and serious concerns have been raised that allowing for widespread gambling on election outcomes could undermine the trust of voters. This type of activity could fuel claims about election fraud, while also posing a risk that those with financial or political interests at stake may be incentivized to interfere in particular elections. At the same time, others have noted that the manipulation of betting markets could serve as a tool for foreign actors seeking to interfere in our democracy. Notably the Commission's 2012 order that prohibited similar contracts to allow for betting on U.S. elections raised concerns about their potential impact on election integrity and ultimately concluded that the proposal was "contrary to the public interest."

Given these potential threats to our system of government, I urge you to give full consideration to these risks as you assess the proposal now before you. Thank you for your attention to this important issue.

Sincerely,



Amy Klobuchar
Chairwoman, U.S. Senate
Committee on Rules and
Administration

APPENDIX B (CONFIDENTIAL) – FURTHER CONSIDERATIONS

Note that much of the material here was included in the original formal preview of the contract that was provided to DMO on March 28, 2022, and also provided to the Commissioners' offices after that.

Hedging and Price Basing Utility

The U.S. Constitution granted Congress extensive powers to influence the economy, including the powers to impose and collect taxes, regulate interstate and international commerce, to create money, to borrow money with American credit, and to appropriate tax revenue. Consequently, shifts in which political parties control government can portend dramatic changes in policy and personnel that could swing the fortunes of entire sectors of the economy. The resulting volatility creates substantial and well-established demand for firms to insure themselves against outcomes contrary to their interests. Unfortunately, the status quo forces these firms to choose between inefficient and indirect forms of hedging this risk and not hedging at all. This section will advance three main areas of analysis:

1. First, political control has predictable and foreseeable impacts on the macro-economy writ large and specific sectors more powerfully.
2. Second, firms already engage in behavior to hedge against such risks, indicating that the need for these hedging products exists.
3. Third, existing hedging options are inferior to being able to trade directly on political control with a CFTC-regulated product.

1. The partisan makeup of government has substantial and predictable economic impact.

The preponderance of the political science literature suggests that changes in political control have consequences. Even if reality complicates the ability to enact every aspect of a given party's agenda, a review of the literature suggests that politicians make a good faith effort to enact roughly two-thirds of their campaign agendas.³ They not only have the ability to shape ambitious pieces of legislation that can affect the disbursement of trillions of dollars, but they possess broad regulatory authority to affect the outcomes of myriad industries. As a consequence, academic studies find that financial markets expect policy changes following elections but before policies are actually enacted. The remainder of this subsection will highlight the evidence provided by private research firms and investors, academic researchers, politically vulnerable firms themselves, and economic policymakers that political control risk is real and hedges are sought.

³ Timothy Hill. 2016. "Trust us: Politicians keep most of their promises". *FiveThirtyEight*.

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Private research firms

In 2020, investment bank research divisions offered projections about the economic and financial impacts of various political outcomes. For example,

- **Goldman Sachs**'s chief economist stated publicly that full Democratic control of government would cause the bank to upgrade their earnings forecast by sharply increasing the probability that a large fiscal stimulus bill would become law.⁴ Full Democratic control would also, according to the bank's insights, "likely include a stimulus package in Q1, followed by infrastructure and climate legislation. In this scenario, we would expect legislation expanding health and other benefits, financed by tax increases, to pass."⁵
- **Morgan Stanley** also cited the chance of stimulus along with infrastructure spending and corporate tax changes as a vehicle for a "blue wave" leading to a weaker dollar, lower interest rates, stronger GDP growth and lower bond prices.⁶⁷
- **JP Morgan Chase** projected that a Democratic victory would lead to a rally in 'left-behind' equities, such as "European cyclical, value, China-exposed stocks and renewables."⁸
- **Bank of America** provided roadmaps for each type of partisan outcome (e.g. one party controls all of government, divided government, et cetera). There, they wrote that full Democratic control of government would lead to \$2-2.5 trillion in stimulus compared to a Biden win with a divided Congress (\$0.5-1 trillion) or a Trump win with a divided Congress (\$1.5-2 trillion). They also detailed impacts to specific sectors, like businesses exposed to Chinese trade, in each scenario.⁹
- **UBS** published a report noting partisan outcomes for policy and the economy, and recommended investors specifically focus on candidates' policy commitments with regards to politically-sensitive industries like energy, health care, financials, and the environment. They noted that their investors should consider how the S&P 500 has performed best in environments where Republicans win, and their clients should make portfolio appropriate adjustments.
- **Moody Analytics**—not an investment bank, but a credit rating agency with a market research division—explicitly estimated that Democratic control of government would result in 4.2% growth between 2020-2024, compared to 3.1% under a Republican control

⁴ Matthew Fox. 2020. "Goldman's chief economist breaks down why a Biden-led blue wave would prompt an upgrade in growth forecasts". *Business Insider*.

⁵ Thomas Franck. 2020. "Goldman Sachs says Democratic sweep would unleash 'substantially' more stimulus." CNBC.

⁶ Morgan Stanley. 2020. "A Revised Guide to Economic Policy Paths & Market Impacts".

⁷ Morgan Stanley. 2020. "2020 US Election Preview: 5 Themes to Watch for Investors."

⁸ Ksenia Galouchko. 2020. "JPMorgan Says Biden Victory Could Mark a Stock Market Shift." Bloomberg.

⁹ Bérengère Sim. 2020. "Bank of America wrote a massive 92-page report on election's impact — here's what investors need to know." Financial News.

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scenario.¹⁰ They similarly projected a one percentage point lower unemployment rate and a 0.6 percentage point higher S&P 500 under a Democratic sweep.

The above research is provided to institutions, who pay for the firms' expertise on the status and future of the economy at great expense. These clients are predominantly money managers, such as hedge funds, pension funds, and other kinds of investment pools. If they did not agree that there are predictable specific economic consequences stemming from the partisan makeup of Congress, they would not pay for this research, nor would they act on it by changing their investment portfolios or hedging the risks from political control. The results of these research firms' research are often reported in the press. Both the fact that trillion-dollar investment funds pay handsomely for this information, and that the press routinely reports on this research suggest that political control has enormous economic impact.

Academic research

University-backed research confirms that the marketplace considers these risks in its operations. Researchers Erik Snowberg, Justin Wolfers, and Eric Zitzewitz used a variety of prediction markets to establish a relationship between the odds of a given party's success in Congressional midterms and financial markets and indicators.¹¹ They found that there was a consistent link between changes in expectations of who would control Congress and the prices of equities, government bonds, and the exchange rates between the U.S. dollar and foreign currencies. The fact that financial markets utilize political control as a pricing factor demonstrates that market participants understand that there are predictable, specific economic consequences to political control. That same team looked at high-frequency trading data immediately following the release of (what turned out to be inaccurate) exit poll data which briefly caused a major change in the odds of a Democratic victory in 2004. Such a sudden spike during what is normally a quiet trading period allowed the researchers to isolate the effects of the changes in political expectations from other economic events during the same period. They concluded that markets expected a Republican victory to result in higher equity prices, interest rates, oil prices, and a stronger dollar than a Democratic one.¹² They reperformed that analysis in 2016, where they found that markets anticipated that a Republican victory would reduce the value of the S&P 500, foreign stock markets, reduce oil prices, and lead to a significant decline in the Mexican Peso, while also increasing future market volatility compared to a Democratic win.¹³ A similar study in 2008 found that Democratic politicians polling higher than Republican ones was better for equity markets.¹⁴

¹⁰ Moody's Analytics. 2020. "The Macroeconomic Consequences: Trump vs. Biden".

¹¹ Erik Snowberg, Justin Wolfers and Eric Zitzewitz. "Party Influence in Congress and the Economy." 2007.

¹² Erik Snowberg, Justin Wolfers and Eric Zitzewitz. "Partisan Impact on the Economy". *Journal of Economic Perspectives*. 2004.

¹³ Justin Wolfers and Eric Zitzewitz. 2016. "What do financial markets think of the 2016 election?"

¹⁴ Demissew Diro Ejara, Raja Nag, and Kamal P. Upadhyaya, 2012. "Opinion polls and the stock market: evidence from the 2008 US presidential election." *Applied Financial Economics*.

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Similarly, Northwestern professor Seema Jayachandran used a natural experiment to study the effects of partisan control of Congress.¹⁵ In 2001, Vermont Senator James Jeffords switched parties from Republican to Democrat, shifting control of the Senate. In what she called “the Jeffords effect”, the equity valuations of firms that donated to Republicans decreased by 0.4%, while the equity valuations of firms that donated to Democrats increased by 0.1%, again indicating the marketplace’s belief that Congressional control has real, predictable consequences. Similarly, Brown University economist Brian Knight found that “under a Bush administration, relative to a counterfactual Gore administration, Bush-favored firms are worth 3% more and Gore-favored firms are worth 6% less, implying a statistically significant differential return of 9%”.¹⁶ Economist Andrea Mattozzi found by regressing Bush- or Gore-affiliated portfolios against surprising poll results, “an increase in the probability of a Bush victory from 50 to 51 percent, increases the annual expected excess return of the Bush portfolio by 25 percent and decrease[s] the annual expected excess return of the Gore portfolio by 35 percent”.¹⁷ These findings—that changes in the expectations or outcomes of partisan political control affect financial markets—have been consistently replicated.¹⁸¹⁹²⁰²¹²²²³²⁴²⁵²⁶

Firm-level testimony

Firms themselves discuss this risk often. In Q3 2020, more than one-third of company quarterly earnings conference calls used the term ‘election’.²⁶ On these calls, concerns were most frequently raised regarding tax reform, additional potential fiscal stimulus, and regulatory changes. In these

¹⁵ Seema Jayachandran. 2006. “The Jeffords Effect”. *Journal of Law and Economics*.

¹⁶ Brian Knight. 2006. “Are policy platforms capitalized into equity prices? Evidence from the Bush/Gore 2000 Presidential Election” *Journal of Public Economics*.

¹⁷ Andrea Mattozzi. 2005. “Can we insure against political uncertainty? Evidence from the U.S. stock market”.

¹⁸ Frederico Belo, Vito D. Gala, and Jun Li. 2013. “Government spending, political cycles, and the cross section of stock returns.” *Journal of Financial Economics*.

¹⁹ Francois Gourio, Michael Siemer, and Adrien Verdelhan. 2015. “Uncertainty and international capital flows.” *Working paper, Federal Reserve Bank of Chicago, MIT*.

²⁰ Kyle Handley and Nuno Limao. 2015. “Trade and investment under policy uncertainty: theory and firm evidence.” *American Economic Journal: Economic Policy*

²¹ Bryan Kelly, Lubos Pastor, and Pietro Veronesi. 2016. “The price of political uncertainty: Theory and evidence from the option market.” *The Journal of Finance*

²² Ralph S. J. Koijen, Tomas J. Philipson, and Harald Uhlig. 2016. “Financial health economics.” *Econometrica*.

²³ Timothy Besley and Hannes Mueller. 2017. “Institutions, volatility, and investment.” *Journal of the European Economic Association*.

²⁴ Philippe Mueller, Alireza Tahbaz-Salehi, and Andrea Vedolin. 2017. “Exchange rates and monetary policy uncertainty.” *The Journal of Finance*.

²⁵ Michael Herron. 2000. “Estimating the Economic Impact of Political Party Competition in the 1992 British Election.” *American Journal of Political Science*.

²⁶ John Butters. 2020. “More than one third of S&P 500 companies are discussing the election on Q3 earnings calls.” Factset.

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conversations, investors frequently ask company executives what the impact of a specific partisan outcome will be (e.g. a “blue wave”, divided government, et cetera) on the company’s bottom line. Consider a few examples, beginning with Raymond W. McDaniel, CEO of Moody’s Corporation, a major credit ratings agency:

...as a starting point, we recognize that there are not going to be identical policies and priorities depending on whether there's a blue wave or whether the Republicans win, hold the Senate, win the Presidency. It's a number of combinations, none of which will produce exactly the same set of priorities and policy elements that will have to address just as our business as well.²⁷

Thomas A. Fanning, CEO of Southern Company, an energy company:

Coal depends on what happens with environmental. And that really depends a lot to a large extent on the elections going forward. If you have a blue wave, it may be that we would see perhaps tighter regulation and co-waning importance, but we'll see.²⁸

Jeffrey Solomon, CEO of Cowen Inc., an investment bank:

So, we're presuming there's a Blue Wave coming. And I would say, we'll take a step back for a second and say, regardless of what the election outcome is, there's some real underpinnings that will ignite growth. First of all, the Fed stays accommodative, regardless of who's in control. I also think there'll be a significant fiscal spending package that happens regardless of who's in control. The difference will be where the money is and the size of the money. I think from a Blue Wave standpoint, if that actually occurs, I think it's fantastic for the market to be clear. Because there will be a much bigger spending package that occurs that will more than offset any drag from tax -- from a tax increase.

So, people tend to pick and choose what they want to focus on. A tax increase could impair valuations or reverse some of the gains that we saw from the last tax cuts. But effectively, we're going to go back to where we were a few years ago. That's really what we're talking about here from a tax standpoint on capital gains, at least anyway. And I think that will be more than offset by the amount of fiscal spend that's going to happen in areas like sustainability.²⁹

Ken Moelis, CEO of Moelis & Company, a boutique investment bank:

²⁷ The Motley Fool. “Moody's Corp (MCO) Q3 2020 Earnings Call Transcript.”

²⁸ The Motley Fool. “Southern Company (SO) Q3 2020 Earnings Call Transcript.”

²⁹ Seeking Alpha. “Cowen Inc. (COWN) CEO Jeffrey Solomon on Q3 2020 Results - Earnings Call Transcript.”

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I think our M&A pace -- feels as high as it's ever been. Our backlog is as strong totally -- as it's ever been. I think it was our second earnings quarter was in late July, we said we started -- we really felt it. And it may be -- that it's -- we deal with a little bit of a growth here -- middle -- a lot of what we do is in the sponsor community and possibly they responded quicker.

I think the larger transactions are a little more affected by -- maybe by the election and tax policy and what happens globally.³⁰

Thomas Peterffy, Chairman of Interactive Brokers, a brokerage firm:

Well, in the last couple of weeks, we do notice some moderation in activity, and -- which would be expected as we come up to the election. And then, of course, I think it will pick up when the results come out, especially if the Senate goes Democratic, I expect that people will start taking the long-term gains because of the expected 43% long-term capital gains tax rate. And then of course, we are looking further down the road, more and more spending that will result in asset inflation, including higher and higher stock prices.

As the New York Times's Conor Dougherty reported in 2016,

Executives at Jack in the Box said uncertainty over the election could be affecting consumers' willingness to buy Jumbo Jacks and cheeseburgers. Commercial real estate brokers said the election was causing businesses to hold off on new office leases. Auto dealers said the results could determine how many people buy cars.

From banking to oil to pharmaceutical companies, to real estate agents and even cruise ship operators, everyone seems to think wariness ahead of the election is affecting their business. Sometimes for the better, mostly for the worse.³¹

Policymakers

The Federal Reserve Board frequently discusses the impact changes in political expectations are having on asset markets in the context of the Board's monetary policy stance. Consider the following from the November 2020 meeting minutes:

Yields on two-year nominal Treasury securities were little changed over the intermeeting period, while longer term yields increased modestly, on net, reportedly reflecting market

³⁰ Seeking Alpha. "Moelis & Company (MC) CEO Ken Moelis on Q3 2020 Results - Earnings Call Transcript."

³¹ Conor Dougherty. 2016. "The Election's Effect on the Economy? Doughnut Sales Are Probably Safe." *The New York Times*.

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participants' reassessments of the election outcome and the outlook for fiscal policy...Broad stock price indexes increased, on balance, over the intermeeting period amid volatility associated with market participants' reactions to news on the U.S. election, the pandemic's trajectory, and the fiscal policy outlook...Uncertainty about additional U.S. fiscal stimulus and the outcome of the U.S. presidential election also caused some asset price volatility abroad.³²

In the December 2016 meeting, the Board discussed the impact of the previous month's electoral outcome on a variety of assets, including Treasury yields, the equity market, overnight index swaps, and corporate bond yields.

Surveys of market participants indicated that revised expectations for government spending and tax policy following the U.S. elections in early November were seen as the most important reasons, among several factors, for the increase in longer-term Treasury yields, the climb in equity valuations, and the rise in the dollar...Asset price movements as well as changes in the expected path for U.S. monetary policy beyond December appeared to be driven largely by expectations of more expansionary fiscal policy in the aftermath of U.S. elections...In addition, the expected federal funds rate path over the next few years implied by quotes on overnight index swap (OIS) rates steepened. Most of the steepening of the expected policy path occurred following the U.S. elections, reportedly in part reflecting investors' perception that the incoming Congress and Administration would enact significant fiscal stimulus measures...Broad U.S. equity price indexes rose over the intermeeting period, apparently boosted by investors' expectations of stronger earnings growth and improved risk sentiment, with much of the rally coming after the U.S. elections...Although gross issuance of corporate bonds slowed notably in October and November from the brisk pace in the third quarter, the decrease in corporate bond spreads after the U.S. elections suggests that the lower issuance did not reflect a tightening of financial conditions.³³

During the December 2012 meeting, Simon Potter, the Federal Reserve's Head of Economic Research said:

The outcome of the election reinforced investors' expectations for a continuation of highly accommodative monetary policy...Some market participants also believe that there is an increased chance of housing policy changes following the election, which would increase refinance activity and origination volumes associated with credit-constrained borrowers.³⁴

³² Minutes of the Federal Open Market Committee. November 4–5, 2020.

³³ Minutes of the Federal Open Market Committee. December 13–14, 2016.

³⁴ Meeting of the Federal Open Market Committee. December 11–12, 2012.

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The Federal Reserve's October 2016 Beige Book (which is the routine survey of various corporations' estimates of their economic outlook) cites electoral risk no fewer than eight times, particularly in construction, auto sales, and commercial real estate.³⁵ This is not a new phenomenon. The Federal Reserve's Beige Book reported in 2012,

Leasing activity is said to be down in Boston as firms say political uncertainty makes them reluctant to make leasing commitments in advance of the national election... A few builders said that they would like to hire more workers but are hesitant to do so because of uncertainty surrounding the upcoming election and the fiscal cliff... Across the board [in the manufacturing sector], contacts noted uncertainty in their outlooks due to the upcoming election.³⁶

The marketplace's expectations of the impacts of changes in political control are so credible that the Federal Reserve uses them when making monetary policy decisions. This provides evidence that such outcomes are a sufficient risk to be hedged.

The necessity of hedging political control itself, not merely policy outcomes

If the mechanism by which politicians affect the economy is through policy change, it might stand to reason that contracts on the outcomes of policy changes are sufficient to provide for full hedging, and there is no need for political control contracts. However, this analysis is incomplete. There are two core reasons why political control contracts add hedging utility above and beyond specific policy contracts.

First is the uncertainty surrounding specific policy outcomes. For example, immediately after the Republican party assumed control of government in 2016, there was widespread sentiment that trade tensions with China would increase. However, little was known about the form that trade tensions with China would take, such as which restrictions might be enacted (tariffs, World Trade Organization lawsuits, sanctions, withdrawal from global free trade agreements, and many more), when those would happen, in what context, and so on. Nonetheless, without any specific policy, market participants were confident that the change in political control implied an increase in trade tensions, prompting recommendations by financial institutions to sell Asian currency, Asian equities, and the Mexican peso.³⁷ Enough was known to change asset prices and investor behavior based on public information. However, because the policy particulars were unknown, there was practically no way for a DCM to provide a market for its Members that would hedge such a risk in advance of policy enactment. Because of its obligations to be specific about resolution mechanisms for manipulation and anti-fraud purposes, a DCM cannot, and should not, propose

³⁵ Summary of Commentary on Current Economic Conditions by Federal Reserve Districts. October 2016.

³⁶ Summary of Commentary on Current Economic Conditions by Federal Reserve Districts. September 2012.

³⁷ Goldman Sachs. "Beyond 2020: Post-election policies."

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vague markets like, “Will the U.S. start a ‘trade war’ somewhere?” or “Will trade tensions increase?” However, a political control event contract would capture this event risk. In this regard, it is precisely because the *particular* economic outcomes of political control are sometimes unclear that the market needs such contracts. Firms need to hedge against parties’ policy stances, e.g. hostile to trade, pro-tax increases, supportive of stringent environmental regulation, etc., *because* the precise implementation of those stances is not identifiable ahead of time.

The second is the breadth of changes political control of government can portend. The impact of congress is much broader and reaches much further than legislation. Consider a firm in the energy sector which is exposed to political risk. It is concerned that a new Congress will increase subsidies for their competitors and there will be new regulations and new procedures imposed on the business. These risks are affected by potential legislation from congress, and also from non-legislative elements like budgets for regulators and signaling to regulatory agencies. There are many subtle and nuanced ways that political control impacts this that it might not even be possible to list contracts on them all, and certainly not feasible. Even events that could be defined might not have widespread enough interest to create a liquid market useful for hedgers to price-take, and many events will not be defined to even have a market on them. Because political control creates so many changes across government, it is easier for firms and exchanges to hedge using the catalyst of policy change itself (the change in political control) rather than all of the many particular policy and personnel outcomes that could come.

Market participants could use political control contracts to hedge the direct and linear change to the risks the political system poses to them, which is similar to how market participants use other, existing contracts to hedge such as hurricane contracts and economic indicator contracts.

Political control contracts could be used by all segments of market participants—retail, small businesses, and enterprise—to hedge their risk exposure to political control.³⁸ Various policy outcomes directly result in economic consequences to which market participants may be vulnerable. Political candidates consistently and vocally signal their competing policy intentions. While the policy might not end up being implemented, the likelihood of such a policy being implemented is greater if the party in favor of that policy has political control, and less if the party in favor of that policy does not have political control. As such, there is a connection between political control and the market participant’s exposure to unfavorable outcomes, and that risk can be hedged like any other. A market participant negatively exposed to a party’s platform would hedge that risk by buying political control contracts that the party in favor of that policy would have political control. Conversely, a market participant who stands to gain from a party’s platform

³⁸ Kalshi currently has a \$25,000 position limit on all of its contracts. This position limit might limit the efficacy of the contract for the largest enterprises, although the market is open to all eligible participants. This position limit is 1/10th the size of Nadex’s position limit on its presidential election contracts. It is sufficient for the needs of many individual participants and some small businesses, and can be used by all market participants to hedge at least a portion of risk.

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would hedge the risk that a policy is not implemented by buying political control contracts that the party in favor of that policy would not have political control.

Even though there is no guarantee or certainty that a party's platform will or will not be implemented to completion regardless of control, the likelihood of the party's platform being implemented will change based on whether the party has political control, and therefore the risk associated with that platform will change too. That change in risk is what political control contracts hedge. Put another way, an outcome does not have to be certain in order to be hedged.

Hedging political control is like hedging any other risk exposure to events: firms and individuals hedge likelihoods, not absolutes. Market participants seeking to hedge risks associated with rising inflation do not know whether the price increases will be concentrated in the exact sector to which they are most exposed or how inflation will actually affect their bottom lines. Yet, because an increase in the broad measure of inflation substantially increases the likelihood that they will be exposed to impacts from inflation, firms hedge accordingly. Individuals in a recession do not know with certainty whether they will lose their job (indeed, most people retain their jobs during recessions). Yet, because a recession substantially increases the probability of losing their job, that change to the risk is hedged. There is a direct, linear connection between the underlying event and a financial risk, regardless of potential uncertainty through intermediate channels.

Consider a contract on whether a hurricane will occur. There is no certainty regarding the impact that a storm will inflict, such as the amount of damage, the type of damage, whether there will be flooding, electrical outages, and so on. There is no guarantee or certainty that a hurricane will cause any damage to any market participant, and there is no guarantee or certainty that a hurricane will make landfall. Yet, market participants hedge the *risk* – the increased likelihood – that they will suffer economic harm because of the hurricane. Hurricane contracts are a staple in OTC markets and on CFTC regulated exchanges like Cantor Fitzgerald and the Chicago Mercantile Exchange because market participants hedge the risk of a hurricane, not just the certainty.³⁹⁴⁰⁴¹

The same is true for a political control contract. Political control changes the likelihood of the economic risks market participants are exposed to. Those changes can be hedged, just like a market participant using a hurricane contract hedges changes to her economic risks from the weather or

³⁹ CX Markets. <https://weather.cxmarkets.com/>

⁴⁰ CME Hurricane Index Futures and Options.

https://www.cmegroup.com/trading/weather/files/WT106_NEWHurricaneFC.pdf

⁴¹ See also *MANAGING CLIMATE RISK IN THE U.S. FINANCIAL SYSTEM*, Report of the Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission (noting, in Chapter 3 that while the specific impacts of climate change are far from known, nonetheless, firms hedge climate change risk. And also discussing, in Chapter 6, “scenario analysis” and “scenario planning”, which it describes as “less about forecasting the most probable outcomes than it is a “what-if” analysis of different potential projections of the future,” and stating that climate-related scenario analysis are being used “by banks and other financial institutions to assess individual investments and overall portfolios.”).

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one using economic indicator contracts hedges the change in her risks from changes to the indicator. Accordingly, if the economic consequences of changes in macroeconomic conditions or weather conditions can be hedged with such contracts, then hedging should also be allowed to mitigate the risk of direct economic consequences from changes in macro-political conditions (i.e., changes to political control) via a political control contract.

Here are several examples of how this would work:

- A firm supplies parts to hydrogen fuel cell companies. One party's platform includes new policies that will disfavor the firm's main clientele. These policies are broad and could end up being reduced subsidies, relaxed requirements to be carbon neutral, the removal of tax breaks, subsidies going to competitors in traditional fossil fuel industries, and others. Any one of these would impact the supply firm's bottom line because there would be less demand for its parts. The likelihood of one of these policies being implemented is greatest if the party proposing these policies is in control, is less if neither party is in control, and is least if the other party, the one who does not have these policies in its platform, is in control. The firm can use political control contracts to hedge the greater risk, whatever its risk management strategy is.
- A firm is a qualified opportunity zone fund under I.R.C. section 1400Z-2. The fund is exposed to changes in the tax laws that relate to it. The likelihood (not the certainty) of an unfavorable tax law being passed is greater if a particular party has political control, less if no party has political control, and even less if another party has political control. As noted above, the market factors political control into investment decisions. Potential investors in the fund might be reluctant to invest because of the risk level of an unfavorable tax policy being implemented. The firm can use the political control contract to hedge that risk according to its risk management strategy to address investors' concerns.
- A small online business imports its inputs from China. The business is exposed to the risk of increased trade tensions. One party's platform includes policies that increase the likelihood of trade tensions. Trade tensions could result in new tariffs (possibly on their inputs, possibly not), changes to existing trade agreements, or threats of such changes that cause market uncertainty, and could result in higher costs. The likelihood of one of these policies being implemented is greatest if the party proposing these policies is in control, is less if neither party is in control, and is least if the other party, the one who does not have these policies in its platform, is in control. The firm can use political control contracts to hedge the greater risk, whatever its risk management strategy is.
- A household is dependent on a new suite of policies enacted in order to maintain their current lifestyle as they raise a new set of children. This includes a newly legislated Child Tax Credit, paid parental leave, and regular stimulus payments. However, these policies are sunsetted, and should a different party take over, they will not be extended. The likelihood of these policies being extended is greatest if the party proposing these policies is in control, is less if neither party is in control, and is least if the other party, the one who

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does not have these policies in its platform, is in control. This household could use a political control contract to hedge the risk that a new party enters government that will be less friendly to a big-government, subsidy-heavy, welfare-state aligned policy agenda.

- An individual is returning to school; however, they are financially constrained. They would be significantly less burdened if a party came into government that has credibly committed to a moratorium on student loan payments, forgiving student debt, making community college free for individuals under a certain income threshold, and expanding the suite of persons eligible for federal grants and subsidized loans. In addition, family members tell them they would be more likely to financially support their return to school under such circumstances. The likelihood of one of these policies being implemented is greatest if the party proposing these policies is in control, is less if neither party is in control, and is least if the other party, the one who does not have these policies in its platform, is in control. Thus, this individual can mitigate the risk associated with tuition and investment in schooling by using a contract on partisan political outcomes to hedge the risk such a party does not enter office.

There is also an economy that is built around Congress and political control. Participants who have economic exposure to the government relations field can use the contract to hedge. The value government relations professionals deliver to their clients is largely dependent on their connections and relationships – if the party the government relations professional is affiliated with does not control Congress, the value to clients is reduced. After all, having relationships with those who control key committees can be more useful than being close with the minority party.⁴² There is a direct linear connection between the party in control of Congress and the likelihood of a decrease in potential value to clients from individual government relations professionals. According to an analysis by OpenSecrets.org based on data from the Senate Office of Public Records, in 2020-2021, over \$7 billion in industry spending was reported.^{43,44} That substantial amount of money is just one facet of the broader government relations economy. Many government relations professionals work for firms that also employ researchers, planners, managers, secretaries, and others. These firms rent offices, hire cleaning crews, and buy insurance policies. They also go to lunch and dinner, travel, and host events that are economically significant to the local hospitality and entertainment industries. All of the individuals and firms that are tied to government relations have economic exposure to the success of government relations firms which have exposure to which party has control over Congress.

⁴² One well known relations firm brags in their marketing materials “Our access to decision makers on Capitol Hill allows us to develop and execute strategic advocacy roadmaps that pair priority needs with concrete methods to achieve them.” *Advocacy - FS Vector*. Several firms, accordingly, are careful to bill themselves as bi-partisan. For example, one firm displays the following quote on their website: No policy battle is too challenging for this bipartisan firm, which is packed with Republican and Democratic power players. *Capitol Counsel LLC*. This further indicates that the success of government relations firms is affected by political control.

⁴³ [Data Summary • OpenSecrets](#)

⁴⁴ [Total spending U.S. 2021 | Statista](#)

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In-house government relations professionals, and the firms that employ them, can also use the contract to hedge their risks. Take, for example, a pharmaceutical company that is looking to expand its government relations team. It has one opening that it intends to fill shortly after the elections in November. The company identifies two equally qualified candidates who both have extensive Hill experience, one that is credentialed with one political party and the second with the other. The company might base its hiring decision on member affiliations on the candidates' resumes, assuming that the candidate that is better connected will be more effective. Thus, the two candidates both have significant exposure to political control and can use the contract to hedge their risk exposures. Similarly, a consulting firm that provides government relations services and has strong connections to party Y determines that party Y will have political control over Congress in an upcoming election. Because of their connections to party Y, the firm expects to see an increase in demand for its services. In order to stay ahead of demand, the firm plans to hire two new IT professionals and a new secretary. The firm might identify that it is at risk of party Y not having political control, in which case the anticipated increase in demand is less likely to materialize. The firm can hedge that risk by utilizing the contract. The applicants to the firm for those jobs can also hedge the risk that party Y does not have political control, and the firm might pull the offers or institute layoffs.

Political control in Congress can have an impact on non-partisan issues as well, such as the design and architecture of how legislation is implemented, and the particular priorities of various committees that impact Congress's business as a whole. These can have significant economic impacts on market participants that can be hedged by using the contract. To illustrate, consider a firm that provides advocacy, government relations, or advisory services. The firm has expertise in a specific field or issue. They can expect to see an increase in demand for its services if there is an increase in government focus on that particular issue. Political parties often differ on key priorities outside of partisan issues, and market participants, through their own thorough research, may determine that there is a likelihood of an increase or decrease in activity based on which political party is in control. Additionally, the impact of political control is not limited to just the potential partisan priorities and political viewpoints of that party. Certain members of a particular party may champion different causes, even if those causes are not necessarily partisan in nature. A given member might also have a familiarity or connection to a particular agency or style of regulating. These differences between members can have significant impacts on industries. Whether that member is in position to advance her agenda may depend on her committee assignment and placement within that committee, for example, a given member might either be the chairwoman of a committee or its ranking member, depending on whether her party has control over the chamber. As chairwoman, she will be in position to shape policy in a manner that is very different than she could as a ranking member. Those differences aren't necessarily partisan in nature, and can range from the nature of the regulatory regime imposed on a nascent industry to which regulatory agency is given jurisdiction over the industry. Market participants, through their own

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thorough research, may determine that there is a greater likelihood of a certain issue coming to the fore if a certain member is in a position of power, which depends on which party has political control.

To give a hypothetical example of how this would work, consider if there was an emerging issue and there was discussion whether to assign jurisdiction over the issue to two hypothetical agencies, one called the QFPB and the other the FTQ. Both agencies are regulated by the same committee of jurisdiction in the Senate. The chair of the committee has close ties to the QFPB and the ranking member's chief of staff worked at FTQ for many years. A policy advocate who used to be the Deputy Director of the FTQ might determine, through her own research, that if the Ranking Member becomes the Chair, it is likely that the issue will be legislated into FTQ's jurisdiction. In addition to the foundational issue of jurisdiction, the ensuing legislation will have many and varied policy points, each one of which will be impactful and provide the policy advocate with work to do advocating on behalf of her clients. That policy advocate might have significant upside if the ranking member becomes the Chair of the committee. Conversely, if the current Chair retains her seat, the policy advocate determines that there is an increased likelihood that the issue is given to the jurisdiction of the QFPB. If that happens, the policy advocate may lose out on that upside, and may even become less relevant. Of course, the policy advocate understands that nothing is guaranteed. These are risks and likelihoods. There is a greater likelihood that she will see increased demand for her services if the ranking member ascends to the chair, and a greater likelihood that she will not if the current chair remains. These likelihoods are risk exposure. The policy advocate can hedge her risk exposure using the contract.

Similarly, demand for think tank services varies based on political control. While some political think tanks, particularly those focused on opposition research and government accountability, thrive when the party they are associated with loses, this is not the case for the most powerful among them. Think tanks like the Center for American Progress and the Heritage Foundation, for instance, are well-known for their associations to Democratic Party and the Republican Party politics respectively. Many staffers at these organizations use their credentials and connections from their time in the think tank space as a launchpad into getting more powerful government roles. Moreover, the appeal of working for these organizations depends on their influence, and the writings of the Heritage Foundation are far more influential when the Republicans are in power than when the Democrats are. As a result, it may be easier to raise money from donors or recruit high-end talent when the think tank can faithfully say "our ideas are constantly influencing important legislation on the issues that matter most to you". As a result, independent of the particular policy outcomes that a Congress may enact, the identity of the party that is in control has a predictable financial impact on thousands of individuals in these industries.

2. Firms already hedge against political control.

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The first section established that despite the uncertainty inherent in the political process, political control has foreseeable impacts on the macroeconomy and specific sectors of the economy. If firms actually believe that these risks need hedging, then they would want to *de facto* insure themselves against the possibility of negative policy change even without CFTC-regulated products that do so. We find that this is the case. Firms and individuals do seek out hedging products to mitigate their own financial exposure to partisan political outcomes.

As noted earlier, private research firms provide analysis on political outcomes for their clients. However, this guidance does not merely discuss the economic impact of certain political outcomes—it also discusses how clients can hedge and avoid the risks associated with a given outcome. In 2020, Goldman Sachs provided a report on how to trade on a clear election outcome; Jefferies created a list of European stocks well-positioned for either a Trump or Biden victory; and Stifel broke down the impacts of many different scenarios, such as “blue sweep” or “Biden stalemate” on major assets and sectors.⁴⁵ Consider this chart from Morgan Stanley, as reported by CNBC:

How to trade the 2020 election

Scenario	Buy	Sell
Democratic President, split Congress	Emerging Markets Alternative Energy	U.S. Energy Big Banks Tech Drugmakers
Republican President, split Congress	Big Banks U.S. Energy Telecom	U.S. Dollar
Democratic President, Democratic Congress	U.S. Dollar Transportation Alternative Energy	U.S. Treasuries Drugmakers Big Banks Tech U.S. Energy
Republican President, Republican Congress	U.S. Dollar Big Banks U.S. Energy	Emerging Markets U.S. Treasuries

SOURCE: Morgan Stanley  46

Or consider this sector-specific example from Stifel, as reported by the Financial Times:

A Blue Wave would suggest a unified federal government more amenable to cannabis reform. We believe a Blue Wave is likely to include numerous headlines promoting the prospect of wholesale federal change, including the descheduling of cannabis (as included in the MORE Act, which was scheduled for a vote in the U.S. House of Representatives) by removing cannabis from the purview of the Controlled Substances Act. Given the heavy

⁴⁵ Jamie Powell. 2020. “How to trade the US election.” *Financial Times*.

⁴⁶ Thomas Franck. 2020. “Morgan Stanley has a simple guide for investors on how to trade the 2020 election.” *CNBC*.

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retail exposure and likely promotion of the potential for federal change, we believe a Blue Wave would bring broad undifferentiated favor to cannabis equities.

This research and analysis is provided by investment banks to institutional investors, such as pension funds, sovereign wealth funds, hedge funds, and even other investment banks. Some of these actors manage trillions of dollars in assets for clients who bear large exposure to predictable political control risk. From the *Financial Times*:

“There absolutely has been a big uptick in election hedging activity,” said Pravit Chintawongvanich at Macro Risk Advisors. “I think that is what is driving volatility. We have seen the Vix rising while the market is relatively quiet. Investors are very specifically targeting the election with expiry a few days or a week after it.”⁴⁷

In addition to providing guidance through their research, a core practice of investment banks is to create specific products to manage risks for clients. In this context, this could take the form of over-the-counter products on political outcomes or a specific portfolio of complex financial assets narrowly tailored to target political control risk. For example, suppose a hedge fund with exposure to for-profit higher education firms wants to hedge against the risk that President Biden will be re-elected, which may enhance the prospects of a regulatory crackdown. It may then seek to purchase other assets that would likely rise if Biden wins, such as green energy stocks or short-sales on particular currencies.

The existence of costly information on how to hedge political control risk, as well as the existence of products targeting it, thus suggests the need for a CFTC-regulated product to mitigate the risk.

3. **Existing hedging mechanisms are exclusive and inefficient.**

Existing mechanisms for hedging political control are inferior to being able to trade directly on the event. Assembling a bespoke portfolio of equities to reduce electoral exposure requires paying substantial fees to investment banks and other dealers to assemble the portfolios. This is unfair and gives an advantage to large, established financial firms over more specialized ones. In addition, it is unavailable to the retail investor and small businesses. This creates an imbalance between the hedging capabilities of retail and institutions, even though retail and small businesses are subject to identical risks. Being able to trade directly would have fewer frictions and fewer costs.

As a result of the high cost of those products, fewer firms choose to try and hedge political risk and instead have to hedge risk themselves. These decisions are opaque, and the public cannot benefit from price discovery since the values of these portfolios are not publicly available. These

⁴⁷ Joe Rennison. 2016. “Hedging activity rises as odds on Donald Trump win fall.” *Financial Times*. <https://www.ft.com/content/ea338340-a3ce-11e6-8b69-02899e8bd9d1>

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hedges are also not able to perfectly isolate political control risk, and end up forcing firms to take on more risk than they would like. This is because the value of these assets (like foreign currencies and politically-sensitive equities) is determined by factors unrelated to the risk, even if political risk is incorporated into its value. Although foreign currencies, major equities, Treasuries, and corporate bonds all are impacted by political control, their values are mostly determined by other fundamentals.

The status quo incentivizes firms to turn to high-cost, exclusive investment banks to create imperfect political control hedge baskets or risk the tides of the market. Yet, the demand for such flawed tools underscores how great the demand for electoral hedging is. Being able to trade directly would thus allow these firms to achieve their same goals but at lower costs, greater transparency and greater certainty.

2. Price Basing Utility

As noted above, political control has predictable economic impact. This impact is felt in many sectors of the economy, and affects individuals, small businesses, and large enterprises. Many of the affected firms themselves support a large ecosystem of economies and the economic risks faced by participants in these economies have direct exposure to the outcome of political control. Accordingly, predictive data on the outcome of political control is very valuable as a tool in economic decision making. For example, if a firm that believes that if a certain party is in control of Congress, its business will benefit and necessitate the hiring of ten new employees and retaining three new service providers would be able to use the data from the contract to determine the probability that the party is in control. That data could be used by the firm to determine how many new employees to hire, if any at all. That data could be used by the firm to determine whether to enter into the new service agreements. It is no wonder that financial news sites such as CNBC have dedicated election channels and regularly feature polls during election cycles. The price embedded in the Contract impacts the pricing of commercial transactions involving physical commodities, financial assets and services. The discussion above regarding hedging policy outcomes makes this point, and in the interests of avoiding duplication it will not be repeated here.

Additionally, there are other contracts, such as MIAX's corporate tax futures, that regard corporate tax rates. Naturally, the probability and potential intensity of tax increases changes with political control, and thus the Contract could be used to price those contracts. Of course, Kalshi and other DCMs have many contracts (such as those on economic indicators, taxes, student debt forgiveness, and more) that are in part dependent on political control.

Moreover, political control can be factored into the price of many physical commodities. For example, a study by economists Erik Snowberg, Justin Wolfers, and Eric Zitzewitz studied the 2004 election and concluded that changes in the probability of Republican political control had

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statistically significant and strong effects on the price of a barrel of oil (among other financial assets, such as the US dollar).⁴⁸

Reuters reported in November 2020 that tighter-than-expected election results were raising S&P futures prices on the expectation that narrow Congressional majorities would limit Congressional Democrats' regulatory ambitions.⁴⁹ *MarketWatch* reported that the election was roiling oil futures markets due to the candidates' differing views on energy policy and environmental regulation.⁵⁰ Agricultural economists even reported that wheat futures rebounded in November 2020 on expectations of changes in US trade policy stemming from President Trump's defeat.⁵¹

Disrupting Misinformation

The preponderance of the academic literature suggests that existing media has misaligned incentives when it comes to reporting on a given party's chances of political control. These incentives tend to come from three sources: first, pundits may want to hype up a preferred candidate's chances in order to flatter the sensibilities of their audience. Second, pundits may want to directly contradict a so-called "mainstream" line about a candidate winning in order to gin up controversy and draw more clicks or viewership. As a result, they may claim an underdog is actually the true favorite and, to further court controversy and viewership, claim that evidence to the contrary is a function of fraud and deception. Third, even when pundits attempt to be honest, viewers themselves may seek out information that confirms their own biases, thus rewarding a subset of biased commentators with greater advertising revenue from the increased viewership or readership. In fact, we have empirical evidence of the poor performance of media figures in the science of prediction. For example, University of Pennsylvania professor Philip Tetlock evaluated the statements made by pundits and found that 15 percent of statements claimed to be "impossible" did indeed occur and 27 percent of statements claimed to be a "sure thing" did not.⁵²

By providing an instant check against pundits, a market-based price created by the Contract can aid information aggregation for the public. For the numerically-inclined or the financially-minded, a viewer can see that one commentator is asserting that candidate X is a "sure thing" but the Kalshi Contract gives them only (e.g.) a 20% chance of winning. They now have a competing alternative to that pundit's information.

⁴⁸ Erik Snowberg, Justin Wolfers and Eric Zitzewitz. "Partisan Impact on the Economy". *Journal of Economic Perspectives*. 2004.

⁴⁹ Noel Randewich. 2020. "S&P 500 futures rise as U.S. election suggests less regulatory risk." *Reuters*.

⁵⁰ Myra P. Saefong. 2020. "Here's how the U.S. presidential election could shake up the oil market." *Marketwatch*.

⁵¹ Matthew Weaver. 2020. "Congressional elections could impact commodity prices most, expert says." *Capital Press*.

⁵² Philip Tetlock. "Expert Political Judgment". 2005.

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Markets tend to be more accurate than any pundit or forecasting alternatives. The efficient, price-discovering nature of markets in a wide range of contexts is a well-substantiated finding in academic research.⁵³⁵⁴⁵⁵⁵⁶ The collective wisdom of many people who have a direct monetary stake in the outcome results in a valuable price signal. Weather derivatives and agricultural futures are better at predicting the weather than meteorologists.⁵⁷⁵⁸ Markets trading on the reproducibility of scientific research are better at discovering which papers will reproduce than experts, who do no better than chance.⁵⁹ Most importantly, research studying IEM and PredictIt have confirmed that markets provide more accurate information than traditional forecasting methods.⁶⁰⁶¹

By creating a visible, well-trusted benchmark against which to evaluate a pundit's predictive power, Tetlock writes, "prudent consumers should become suspicious" when they confront a public record of poor performance relative to the market. In Tetlock's words, "Unadjusted ex ante forecasting performance tells consumers in the media, business, and government what most want to know: how good are these guys in telling us what will happen next?"

⁵³ Justin Wolfers and Eric Zitzewitz. 2004. "Prediction Markets." *Journal of Economic Perspectives*.

⁵⁴ Kenneth J. Arrow, Robert Forsythe, Michael Gorham, Robert Hahn, Robin Hanson, John O. Ledyard, Saul Levmore, Robert Litan, Paul Milgrom, Forrest D. Nelson, George R. Neumann, Marco Ottaviani, Thomas C. Schelling, Robert J. Shiller, Vernon L. Smith, Erik Snowberg, Cass R. Sunstein, Paul C. Tetlock, Philip E. Tetlock, Hal R. Varian, Justin Wolfers, and Eric Zitzewitz. 2008. "The Promise of Prediction Markets." *Science Magazine*.

⁵⁵ Joyce Berg, Forrest D. Nelson, and Thomas A. Reitz. 2008. "Chapter 80 Results from a Dozen Years of Election Futures Markets Research." *Handbook of Experimental Economics Results*.

⁵⁶ Georgios Tziralis and Ilias P. Tatsiopoulos. 2007. "Prediction Markets: An Extended Literature Review." *The Journal of Prediction Markets*.

⁵⁷ Richard Roll. 1984. "Orange Juice and Weather." *The American Economic Review*.

⁵⁸ Matthias Ritter. 2012. "Can the market forecast the weather better than meteorologists?" *Economic Risk*.

⁵⁹ Anne Dreber, Thomas Pfeiffer, Johan Almenberg, Siri Isaksson, Brad Wilson, Yiling Chen, Brain A. Nosek, and Magnus Johannesson. 2015. "Using prediction markets to estimate the reproducibility of scientific research." *PNAS*.

⁶⁰ Joyce Berg, Forrest D. Nelson, and Thomas A. Reitz. 2008. "Chapter 80 Results from a Dozen Years of Election Futures Markets Research." *Handbook of Experimental Economics Results*.

⁶¹ Joyce Berg, Forrest D. Nelson, and Thomas A. Reitz. 2006. "Prediction market accuracy in the long run." *International Journal of Forecasting*.

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*KalshiEX LLC - Confidential***APPENDIX B.1 (CONFIDENTIAL) - EXTENDED CASE STUDIES ON THE HEDGING, PRICE BASING UTILITIES OF THE CONTRACT AND POLITICAL EXPECTATIONS**

Below are several case studies involving different sectors of the economy and regulation that demonstrate the hedging and price basing utilities of the contract; as well as the link between political expectations and outcomes.

Case Study from 2020: Energy Policy

Presidential administrations and Congress have large discretion over - and opportunity to impact with great intensity - the domestic energy landscape. They can initiate regulatory changes with implications for permitting, emissions standards and other environmental standards that could impact the profitability of different firms. In 2020, several of these issues were at stake: as delineated by the Atlantic Council's David Goldwyn and Andrea Clabough, the differences between a Democratic and Republican could hardly have been more stark.⁶² More Republican control, for example, would likely have ushered in greater drilling opportunities in the Arctic and Atlantic coastlines, faster review processes under the Clean Water Act and National Environmental Policy Acts and relaxed emissions standards for fossil fuel-fired power plants. If the hypothesis that changes in the partisan makeup of Congress create *predictable and foreseeable economic outcomes* is correct, then we should expect to see these policy differences manifested in the equity prices of different energy companies. When positive news about Republicans' chances emerge, the stock prices of fossil fuel companies would likely rise. When positive news about the Democrats' chances surface, renewable energy stocks would rally.

Indeed, this prediction is borne out by reality. As reported by CNBC, "expectations of an infusion of investment in alternative energy should Democratic challenger Joe Biden win the presidency have sent the TAN solar ETF soaring this year, up 123%."⁶³ Bloomberg reported that on the days following election night, when early returns seemed to make the prospect of a Democratic Senate slim, renewable stocks "slumped" while oil and gas stocks like ConocoPhillips "rallied".⁶⁴ One major solar provider FirstSolar's stock was so tightly linked to election returns that it fell immediately following election day (when Trump's re-election seemed likely) before spiking 11% when the election was finally called for Biden.⁶⁵ It's worth flagging that these benefits do not merely accrue to large corporations. From small-scale solar panel installers, to wind turbine

⁶² David Goldwyn and Andrea Clabough. 2020. "Election 2020: What's at Stake for Energy?" *Atlantic Council*.

⁶³ Keris Lahiff. 2020. "Biden's prospects send solar stocks soaring, but trader sees trouble ahead." *CNBC*.

⁶⁴ Will Wade, Brian Eckhouse and Gerson Freitas Jr. 2020. "Investors Sour on Green Wave as Democrats' Hope for Senate Fades." *Bloomberg*.

⁶⁵ Matthew Farmer. 2020. "How have US energy stock prices reacted to Biden's US election win?" *Power Technology*.

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technicians, to coal miners, the value of an electoral hedge is valuable regardless of one's financial resources.

Tax, Investment Decision-Making & the 2016 Election

The complete Republican victory in the 2016 Presidential and Congressional elections resulted in the swift passage of a tax reform bill that reduced corporate taxes, modified major tax deductions (such as the child tax credit, mortgage interest rate deduction, and the state and local tax deduction), and enabled accelerated expensing for certain short-lived investments such as machinery.

Consider a shipping company like UPS or FedEx that is trying to decide whether or not to invest in a major new distribution hub. These centers—which involve hundreds of thousands of square feet of floor space, vast technology for package processing, and complex logistics involving trucks and airplanes—can cost in excess of \$1 billion to construct, with smaller centers costing \$10 million to \$50 million.⁶⁶⁷ These investment decisions must be made in advance but are highly sensitive to changes in the tax code. If the 2017 tax cut bill never becomes law, for a \$100 million investment in machinery that lasts 10 years, one can only deduct \$10 million in taxes (in contrast, the company can deduct the full \$100 million in year one under the full expensing provision). The tax bill for that company then decreases by a full \$32.9 million in year one through the lowered headline rate and the new depreciation rules. While these gains would be smaller in future years, due to the time value of money, the combination of the bonus depreciation rules and the lower headline rate could be the difference between making the decision to invest and deciding not to. These benefits are not hypothetical. The Tax Foundation's review of the economic literature estimates that full expensing boosts investment by roughly 2.5%.⁶⁸ Since major investments must be planned in advance, knowing the probability that a party will enter power plays a role in corporate decision-making. The decision whether or not to engage in certain commercial transactions (willingness to accept a good at certain prices) can thus depend on the price of a political control contract.

The benefits accrue to retail investors such as individuals and small businesses. If someone is trying to decide whether or not to take on a mortgage or move to a new state, knowing whether the mortgage interest rate deduction or the state and local tax deduction will be limited becomes relevant. A couple deciding whether their financial situation is stable enough to start a family may care about the generosity of the child tax credit. A young worker trying to decide whether to start their own business might want to know whether their headline tax rates will be lower in the future.

Health Insurance Decision-Making & the 2016 Election

⁶⁶ Jacob Steimer. 2020. "Follow FedEx's money." *Memphis Business Journal*.

⁶⁷ Greg Clinton. "What does it cost to build a FedEx distribution center?" *Buildzoom*.

⁶⁸ Anna Tyger. 2019. "New Evidence on the Benefits of Full Expensing." *Tax Foundation*.

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Much like the campaign four years prior, Republicans in 2016 repeatedly promised to repeal the Affordable Care Act. Ultimately, they removed some components—the individual mandate, the Cadillac tax, and the medical device tax—while keeping components like the individual market subsidies.

Studies found that policy uncertainty had negative effects on the health insurance marketplace. According to one study from the Urban Institute, “uncertainty over how Congress will act and when insurers will obtain information about the rules under which they must operate will lead many to reassess their participation in these markets and others to significantly increase premiums.”⁶⁹ After all, few entrants wish to begin offerings in an individual marketplace that may soon be eliminated, or for whom much of the rationale for entrance (everyone is forced to buy insurance, the insurance is heavily subsidized by the public) might soon be yanked away. The study emphasizes that health insurance companies were confident that they could handle a repeal, reform or maintenance of the status quo. What deterred them was not the change—it was *uncertainty about change*. When one doesn’t know who is going to win an election, it is difficult to make long-term business plans for the future.

Therein lies the price-basing utility for political control contracts. If a health insurance company is deciding whether to enter a marketplace or deciding what rates to set, they need to know the policy environment they will be facing. But that policy environment depends directly on who controls Congress and the Presidency. As a result, the information embedded in the price of a political control contract has a direct bearing on services.

The price-basing utility is also strong for retail investors such as individuals and small businesses. One fear individuals have when deciding to start their own business is the loss of health insurance.⁷⁰ Knowing whether or not one’s individual insurance subsidies will persist two years from now can be important to making the best decision for ones’ family.

Energy Sector Decision-Making & the 2020 Election

Many energy investments take years to come into fruition. Utility-scale solar plants take around 5 years to build, with nearly all of the time related to permitting, siting and environmental review.⁷¹ Nuclear plants can often take even longer.⁷² Building major transmission lines can take decades as

⁶⁹ Sabrina Corlette, Kevin Lucia, Justin Giovannelli and Dania Palanker. 2017. “Uncertain Future for Affordable Care Act Leads Insurers to Rethink Participation, Prices.” *Urban Institute*.

⁷⁰ Robert W. Fairlie, Kanika Kapur, Susan M. Gates. 2011. “Does Employer-Based Health Insurance Discourage Entrepreneurship and New Business Creation?” *Rand Corporation*.

⁷¹ “Siting, Permitting & Land Use for Utility-Scale Solar.” *Solar Energy Industries Association*.

⁷² Pedro Carajilescov and João M. L. Moreira. 2011. “Construction Time of PWRs.” *International Nuclear Atlantic Conference*.

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disputes over land wind their way through the court system.⁷³ Energy investments must thus be made well in advance of going to market, and companies must secure financing and make financial projections with significant policy uncertainty. As shown above, elections have meaningful effects on the profitability of energy investments, as they can result in different levels of subsidies, environmental scrutiny, deductibility eligibility, and beyond.

Policy uncertainty is a deterrent in renewable energy investment. As Professor Kelly Burns writes, “there is a clear inverse relationship between trends in REI [renewable energy investment] and EPU [economic policy uncertainty]...when the level of EPU rises (falls), the level of REI falls (rises). This is evidence that EPU influences REI in the USA.”⁷⁴ Studies repeatedly show that uncertainty over whether the wind production tax credit will be extended, for instance, is a deterrent to financing new utility-scale wind farms.⁷⁵ The same dynamic exists in fossil fuel generation. An S&P Global report cites many coal executives, who said that they could only make investments in new coal generation if the Republicans won a trifecta in 2020.⁷⁷ They reported,

The lack of focus on coal in the 2020 campaign reflects the “highly unlikely” prospects of a revival in coal-fired generation, which would only occur if the federal government subsidized coal production, said Ethan Zindler, head of Americas for BloombergNEF. Such an effort would require unified Republican Party control of the U.S. Congress and the White House come January 2021, the chances of which are “next to none” based on pre-Election Day polling.... Building a coal-fired power plant comes with regulatory and policy risks managed over multiyear permitting and construction timelines for plants where it may take decades to recoup the investment.

ADDITIONAL CASE STUDIES DEMONSTRATING THE LINK BETWEEN POLITICAL CONTROL EXPECTATIONS AND ECONOMIC OUTCOMES

Case Study from 2010: Budget & Debt Ceiling Showdowns

⁷³ Associated Press. 2022. “Hydro-Quebec halts work on its part of hydropower corridor.” *Spectrum News*.

⁷⁴ Kelly Burns. 2019. “On the Relationship between Policy Uncertainty and Investment in Renewable Energy.” *International Association for Energy Economics*.

⁷⁵ Barradale, Jones Merrill. 2010. “Impact of public policy uncertainty on renewable energy investment: Wind power and the production tax credit.” *Energy Policy*.

⁷⁶ Derya Eryilmaz and Frances R. Homans. 2016. “How does uncertainty in renewable energy policy affect decisions to invest in wind energy?” *Electricity Journal*.

⁷⁷ Jacob Holzman and Taylor Kuykendall. 2020. “Coal sees diminished role in US presidential race with odds slim for new plants.” *S&P Global*.

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In President Barack Obama's words, the Democrats took a "shellacking" in 2010, as Republicans flipped 60 seats in the House and six seats in the Senate.⁷⁸⁷⁹ As a result, instead of unified Democratic control (as existed from 2009-10), Democrats needed Republican approval in the House to pass any legislation. In an era of heightened polarization, this "split Congress" ground routine government operations to a halt.

The tensions reached a head in summer 2011, a scant few months after the new Congress started. Republicans and Democrats failed to reach an agreement to raise the debt ceiling—a heretofore uncontroversial practice—thrusting the country into economic turmoil. IMF economist Filippo Gorri estimated that the "disagreement between Republicans and Democrats over the rise in the US debt ceiling" raised US government credit default swap costs by 46 basis points and bank financing costs by 18 basis points.⁸⁰ A U.S. Department of the Treasury retrospective determined that the 2011 debt ceiling shutdown increased volatility, widened credit spreads and slowed job growth for months after the crisis was ultimately resolved, as consumer confidence fell 22 percent.⁸¹ As they wrote,

The United States has never defaulted on its obligations, and the U. S. dollar and Treasury securities are at the center of the international financial system. A default would be unprecedented and has the potential to be catastrophic: credit markets could freeze, the value of the dollar could plummet, U.S. interest rates could skyrocket, the negative spillovers could reverberate around the world, and there might be a financial crisis and recession that could echo the events of 2008 or worse. Political brinkmanship that engenders even the prospect of a default can be disruptive to financial markets and American businesses and families.⁸²

They wrote further,

The S&P 500 index of equity prices fell about 17 percent in the period surrounding the 2011 debt limit debate and did not recover to its average over the first half of the year until into 2012. Roughly half of US households own stocks either directly or indirectly through mutual funds or 401(k) accounts, so this fall in equity prices reduced household wealth across a wide swath of the economy. Between the second and third quarter of 2011, household wealth fell \$2.4 trillion. A decline in household wealth tends, all else equal, to lead to a decline in consumption spending, and consumer spending accounts for roughly

⁷⁸ Liz Halloran. 2010. "Obama Humbled By Election 'Shellacking'." *National Public Radio*.

⁷⁹ Paul Harris and Ewan MacAskill. 2010. "US midterm election results herald new political era as Republicans take House." *The Guardian*.

⁸⁰ Filippo Gori. 2021. "The cost of political uncertainty: Lessons from the 2011 US debt ceiling crisis." *Vox EU*.

⁸¹ Department of the Treasury. 2013. "The potential macroeconomic effect of debt ceiling brinkmanship."

⁸² *Ibid*

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70 percent of GDP. Moreover, because a good deal of retirement savings is invested in stocks, lower stock prices reduce retirement security – from the second to the third quarter of 2011, retirement assets fell \$800 billion. Businesses are also affected by stock prices because they rely on both debt and equity financing. When stock prices fall, investment or other spending to expand a business is more costly. The effects on households and businesses, moreover, are reinforcing. Less capacity and willingness of households to spend, when businesses have less incentive to invest, hire, and expand production, all lead to weaker economic activity.⁸³

Certain businesses and households felt this brunt more than others. Banks use Treasuries as “risk-free” collateral in nearly all of their short-term lending and borrowing activities—a technical default would destroy this bedrock of the financial system. Because interest rates on Treasuries directly impact mortgage rates, the U.S. Department of the Treasury estimates that the 70 basis point jump in mortgage costs in the summer of 2011 cost the average household \$100/month.⁸⁴

The budget showdowns hardly ended with the conclusion of the debt ceiling crisis. To resolve the crisis, President Obama signed the compromise Budget Control Act of 2011 (often called “the Fiscal Cliff”), which applied an across-the-board government spending cut. The Congressional Budget Office estimated in 2012 that had the cuts gone into full effect (they were eventually partially reversed), the drop in growth would be so severe that it would send the country back into recession.⁸⁵ In total, they estimated the impact of the fiscal cliff to be 3.6 percent of GDP lost in 2013. While some of these changes were ultimately reversed in 2013 with the American Taxpayer Relief Act of 2013, many of the cuts were still enacted (called “the sequester”), including \$42 billion in defense industry cuts and \$11 billion in Medicare cuts. The bill cut reimbursements to physicians by 2%, and an American Hospital Association/American Medical Association study estimated that it cost the healthcare industry 500,000 jobs.⁸⁶ Pharmaceutical companies were also acutely harmed by the decimation of the FDA’s budget for inspections, which slowed approval times for new drugs and devices.⁸⁷

It is important to establish that these effects were *downstream of the change in partisan makeup of Congress*. Had either party—the Democrats or the Republicans—won unified control of the government, then these debt ceiling fights would likely have been avoided, as they had been in years past. These fights were also readily predictable prior to the Republican takeover. The Republicans ran first and foremost on a campaign of deficit spending and small government.⁸⁸ The

⁸³ Ibid

⁸⁴ Ibid

⁸⁵ Congressional Budget Office. 2012. “Economic Effects of Reducing the Fiscal Restraint That Is Scheduled to Occur in 2013.”

⁸⁶ Katie Booth . 2013. “Impact of the Sequester on Health Care: By the Numbers.” *Bill of Health*.

⁸⁷ Amy Filbin. 2013. “Funding Cutbacks at FDA: A Sequester Primer.” *REDICA Systems*.

⁸⁸ Brian Weld. 2010. “A Pledge to America.” *The Washington Post*.

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political press made it very clear prior that the debt ceiling would be a major showdown.⁸⁹⁹⁰ The Republican “Pledge to America” (written by leader Kevin McCarthy) called for “strict budget caps” in order to prevent an increase in the debt, an obvious non-starter with Democratic leaders.⁹¹ As Representative (and future Vice President) Mike Pence of Indiana said in late 2010, “There will be no compromise on stopping runaway spending, deficits and debt.”⁹² The Republican nominee for the Senate seat in Colorado Ken Buck continued, “When it comes to spending, I’m not compromising. I don’t care who, what, when or where, I’m not compromising.” The budget showdown emerged in early summer, just five months after Republicans first held a majority.

Importantly, it is *not* sufficient to offer an event contract on a government shutdown or default. After all, consumers and businesses lost billions of dollars *even though the government remained open and the government did not default on its debt*. Rather, the harms manifested because the partisan breakdown of Congress dramatically raised financial uncertainty, and financial markets tend to compensate for the additional risk. Suppose a retail investor with a mortgage tried to hedge their risk by buying a contract on whether the US will default on its debt. They will be insufficiently hedged as they lost hundreds per year even though the country did not default. Moreover, it is not plausible to anticipate the precise form that a resolution to the standoff would take far enough in the future to be useful to families and firms. It is well-known that cuts to spending and budgetary uncertainty would manifest, but policy-specific contracts require an impractical level of foresight. As a result, political control contracts alone are sufficient to provide an adequate level of hedging.

Case Study from 2012: Political Gridlock and Health Care

While headlines in 2012 pitted incumbent President Barack Obama against former Massachusetts governor (and now Utah Senator) Mitt Romney, Congressional control had an equally dramatic effect on the economy. In particular, due to the flagging economic recovery, a major economic reform bill was expected to come before Congress. If the Democrats gained unified control, it was likely a major stimulus along the lines of the proposed American Jobs Act (with hundreds of billions in spending on schools and other traditional Democratic priorities) would have become law. Had Republicans gained unified control, major spending cuts and deregulation along the lines of the (successfully passed) JOBS Act would likely have been implemented. In particular, the Republican Party platform promised an end to taxes on capital gains, interest, and dividends for middle-class taxpayers, along with the end to the estate tax and the Alternative Minimum Tax.⁹³

⁸⁹ Corey Dade. 2010. “Tea Party: From Fringe Element To Power Player.” *NPR*.

⁹⁰ David Min. 2010. “The Big Freeze.” *Center for American Progress*.

⁹¹ Brian Weld. 2010. “A Pledge to America.” *The Washington Post*.

⁹² Andy Barr. 2010. “The GOP’s no-compromise pledge.” *Politico*.

⁹³ Republican Party. 2012. “Restoring the American Dream: Rebuilding the Economy and Creating Jobs.” *The American Presidency Project*.

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Congressional candidates, along with nominee Mitt Romney, repeatedly promised a territorial system of taxation (which would exempt US multinationals from paying taxes on profits earned abroad) and a reduction in the overall corporate tax rate.

Perhaps the clearest contrast emerged in health care. Mitt Romney and Congressional Republicans repeatedly pledged to repeal President Obama's signature legislative achievement—the Affordable Care and Patient Protection Act of 2010 (“ACA”, aka “Obamacare”)—upon entering office. The aforementioned Pledge to America promised to repeal the ACA no fewer than three times.⁹⁴ The Republican-controlled House of Representatives voted to repeal the law no fewer than thirty-three times between 2011 and 2012.⁹⁵ By removing subsidies for tens of millions of Americans to buy insurance (in addition to removing the health insurance mandate), many existing health insurance companies would be harmed by such a proposal. For example, the CEO of the pharmaceutical company AmerisourceBergen specifically endorsed the Affordable Care Act on the belief that expanded insurance coverage would increase demand for his company's products.⁹⁶ Meanwhile, many medical technology companies—who are subject to a tax under the health care bill—would save millions of dollars per year from the Republican plan. Indeed, insurance and health care company stocks were volatile in the weeks up before the 2012 elections for fear of an eventual ACA repeal.⁹⁷ For example, hospital stocks fell 1-3% after Romney's strong first debate performance raised the probability of an eventual Republican victory.⁹⁸ As reported by Reuters,

Romney's perceived win in the debate accounted for the negative outlook on hospital stocks on Thursday, Wells Fargo Securities analyst Gary Lieberman said. “Hospitals had been rallying on the likelihood of Obama's healthcare reform getting implemented as it looked like he had pulled ahead in polls,” Lieberman said. But Romney's Wednesday performance showed the race was tightening, increasing the risk to hospital stocks, RBC Capital Markets analyst Frank Morgan said.⁹⁹

Of course, the effects were not limited to corporations. Americans with pre-existing conditions would likely be harmed by the repeal, as the ACA required health insurance companies to offer health insurance to those with pre-existing conditions whereas prior to the bill it was often difficult to obtain affordable coverage. Meanwhile, community rating and age-banding limited premium increases for older adults, lowering their premiums. In contrast, a repeal might have benefited younger, healthier Americans who would no longer need to cross-subsidize older or sicker adults. Since an ACA repeal would also result in the removal of the requirement that health insurance

⁹⁴ Brian Weld. 2010. “A Pledge to America.” *The Washington Post*.

⁹⁵ Wendell Potter. 2012. “Why insurers want ObamaCare's Medicaid business.” *Tucson Sentinel*.

⁹⁶ David Sell. 2012. “Q&A with AmerisourceBergen CEO Steven Collis.” *The Philadelphia Inquirer*.

⁹⁷ 2012. “Insurers, Hospital Stocks Register Presidential Election Jitters” *KHN*.

⁹⁸ Reuters staff. 2012. “Hospital stocks fall on Romney debate performance.” *Reuters*.

⁹⁹ *Ibid*

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companies cover a wide swathe of ailments such as smoking cessation devices, many younger or healthier Americans could see lower premiums by no longer having to pay for such items in their insurance. While the net effect of the bill remains hotly contested, 1) the economic effects of the bill and its repeal on specific sub-groups were identifiable, 2) the repeal of the Affordable Care Act was a predictable consequence of Republican control of government.¹⁰⁰¹⁰¹¹⁰²

Of course, because the voters delivered a split Congress, neither of these tax or health care repeal proposals became law. Voters largely restored the status quo ante, with Democrats controlling the Presidency and the Senate, while Republicans controlled the House of Representatives.¹⁰³¹⁰⁴ As a result, little legislative action happened, with Congress passing the fewest major bills in decades.¹⁰⁵¹⁰⁶

While on the surface it appears as if there was no impact since control did not change, the truth tells a more nuanced story. Just a few percentage points of votes separated unified Democratic control from unified Republican control. Either of those scenarios would have altered the economic landscape for households and corporations alike. As such, a split government had economic consequences by foreclosing the possibility of unified control.

This example, as in the one above, precisely illustrates how hedging the partisan makeup of Congress is important for businesses and individuals alike. Insurance companies may use millions of customers from an ACA repeal, but households lose the insurance itself. In the status quo, that risk is *unhedgeable*. In fact, considering how the size of ACA subsidies downscale with income (i.e. people with lower incomes receive more benefits), the hedge is most valuable to those with the least income.

Case Study from 2016: Tax reform

Then candidate Donald J. Trump indicated his intention to dramatically change the tax code upon ascension to the nation's highest office. In August 2016, he unveiled a tax plan that he promised

¹⁰⁰ Sara R. Collins, Stuart Guterman, Rachel Nuzum, Mark A. Zezza, Tracy Garber, and Jennie Smith. 2012. "Health Care in the 2012 Presidential Election: How the Obama and Romney Plans Stack Up." *The Commonwealth Fund*.

¹⁰¹ Klein, Ezra. 2012. "The most important issue of this election: Obamacare." *The Washington Post*.

¹⁰² Robert J. Blendon, John M. Benson, and Amanda Brulé. 2012. "Understanding Health Care in the 2012 Election." *The New England Journal of Medicine*.

¹⁰³ 2012. "President Map." *The New York Times*.

¹⁰⁴ 2012. "United States Congressional elections results, 2012." *Ballotpedia*.

¹⁰⁵ Philip Bump. 2014. "The 113th Congress is historically good at not passing bills." *The Washington Post*.

¹⁰⁶ Drew Desilver. 2014. "Congress continues its streak of passing few significant laws." *Pew Research Center*.

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would be the biggest since the Reagan administration, offering tax cuts to Americans at every income level, “streamlining deductions” and reducing tax liability for US corporations.¹⁰⁷

Market participants believed these promises were credible. As the New York Times reported, “the bounce-back in stocks [after the 2016 Republican victory] reflects the bet being made by many investors that Mr. Trump’s promises to increase government spending, cut taxes and ease financial regulations will outweigh his anti-trade rhetoric.”¹⁰⁸ Vox further reported, “The [stock market] rally started off powered by banking stocks, but it has spread across industries. It appears to be fueled by both improving economic indicators and a buoyant optimism about the prospects for sharp tax cuts and sweeping deregulation under unified Republican government in Washington. And it coincides with a spike in business confidence that can only be seen as a reaction to Trump’s victory.”¹⁰⁹

Importantly, none of these tax changes could be enacted without the Republicans winning control of both the House of Representatives and the Senate. Democrats uniformly opposed such cuts and the bill—the Tax Cut and Jobs Act of 2017—was ultimately passed on a party-line basis with no Democrats in the Senate supporting its passage.¹¹⁰¹¹¹ As a result, unified control over government was a prerequisite to the passage of the tax cut bill. There were two primary channels by which these taxes impacted financial outcomes for businesses.

First, lower headline rates meant that corporations can retain more of their profits as opposed to disbursing them in taxes. For some corporations, slashing the top corporate tax rate from its previous peak at 35% to its current top rate of 21% saved the bottom line billions of dollars.¹¹²¹¹³ As a study by economists Javier Garcia-Bernando, Petr Jansky and Gabriel Zucman found, the Act caused a “10 percentage point decline in the effective tax rate on domestic profits”.¹¹⁴ As the Congressional Research Service wrote,

The Act would reduce individual income taxes by \$65 billion, corporate income taxes by \$94 billion, and other taxes by \$3 billion, for a total reduction of \$163 billion in FY2018... From 2017 to 2018, the estimated average corporate tax rate fell from 23.4% to 12.1% and

¹⁰⁷ John W. Schoen. 2016. “Trump touts sweeping, and costly, tax-cut plan.” *CNBC*.

¹⁰⁸ Landon Thomas, Jr. 2016. “Why Stock Markets, Initially Shaken, Went Up After Trump’s Victory.” *The New York Times*.

¹⁰⁹ Jim Tankersley. 2017. “Why the stock market loves Donald Trump.” *Vox*.

¹¹⁰ Scott Horsley. 2016. “The Issues: Explaining Hillary Clinton’s And Donald Trump’s Tax Plans.” *NPR*.

¹¹¹ H.R.1, 115th Congress. <https://www.congress.gov/bill/115th-congress/house-bill/1/actions>

¹¹² 2020. “How does the corporate income tax work?” *Tax Policy Center*.

¹¹³ 2021. “Big Businesses That Banked Tens of Billions From Trump Tax Cuts Now Lobbying On Plans To Make Them Pay Their Fair Share.” *Accountable.us*

¹¹⁴ Javier Garcia-Bernando, Petr Janský, and Gabriel Zucman. “Did the Tax Cuts and Jobs Act Reduce Profit Shifting by US Multinational Companies?”

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individual income taxes as a percentage of personal income fell slightly from 9.6% to 9.2%.¹¹⁵

Second, changes in the tax treatment of capital asset depreciation can be decisive for capital-intensive firms. As a candidate, Donald Trump promised to allow firms to expense the full value of their investments in the year they made them, as opposed to writing off the cost over the lifespan of the asset.¹¹⁶ For firms with large capital expenditures, immediate expensing could allow them to recoup millions in tax savings immediately, instead of slowly over time. Due to the time value of money (a dollar today is worth more than a dollar ten years from now) and the liquidity benefits of being able to reduce tax expenditures in the same year one had to spend, the promised expensing reform was transformative for capital-intensive industries, making more investments profitable than before.¹¹⁷ The Congressional Research Service wrote further,

Estimates indicate that the user cost of capital for equipment declined by 2.7% and the user cost of structures declined by 11.7% ... than that of structures primarily because more of the cost for equipment is for depreciation.¹¹⁸

The Institution of Tax and Economic Policy estimated that the bonus depreciation alone saved twenty corporations more than \$26 billion in 2018 and 2019.¹¹⁹ Some companies that invest in large amounts of equipment, vehicles and machinery, such as Amazon, EOG (formerly Enron Oil and Gas), Delta Airlines, General Motors, FedEx, UPS, Intel, United Airlines, and Verizon saw more than \$1 billion in savings each from that single provision.

Even non-corporations were dramatically impacted by the change in the tax code. The bill lowered the limit of mortgage deductibility to \$750,000 and eliminated the deductibility for home equity interest.¹²⁰ Meanwhile, the deduction for state and local taxes was capped at \$10,000, substantially raising taxes for those in high-tax jurisdictions such as California, New York and New Jersey. Meanwhile, for parents and those who do not itemize, the near doubling of the standard deduction and child tax credit substantially reduced the taxes they needed to pay. One Niskanen Center report estimates that the changes to the child tax credit lifted 750,000 people out of poverty, of which

¹¹⁵ Jane G. Gravelle and Donald J. Marples. 2019. "The Economic Effects of the 2017 Tax Revision: Preliminary Observations." *Congressional Research Service*.

¹¹⁶ Steven M. Rosenthal. 2016. "Making tax shelters great again!" *Tax Policy Center*.

¹¹⁷ Anna Tyger. 2019. "New Evidence on the Benefits of Full Expensing." *Tax Policy Center*.

¹¹⁸ Jane G. Gravelle and Donald J. Marples. 2019. "The Economic Effects of the 2017 Tax Revision: Preliminary Observations." *Congressional Research Service*.

¹¹⁹ Matthew Gardner and Steve Wamhoff. 2020. "Depreciation Breaks Have Saved 20 Major Corporations \$26.5 Billion Over Past Two Years." *Institute on Taxation and Economic Policy*.

¹²⁰ Joseph A. Bellinghieri. "Key provisions of the Tax Cuts and Jobs Act." *MacElree Harvey*.

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roughly half were children.¹²¹ According to an analysis by the Tax Foundation, people earning \$20,000-\$30,000 saved an additional 13.5% on their taxes each year from the tax reform. As a result, the hedge is valuable not just to large corporations, but to regular American families as well.

This analysis is not merely with the benefit of hindsight: these proposals and their downstream effects on corporations were well-identified prior to the change in government. Economic newsletters were advising their clientele to buy bank stocks as a proxy for a Republican victory, as they would benefit most from the proposed tax plan.¹²² In short, Republican control was a *necessary prerequisite to the passage of a major tax bill associated with major economic effects*. These effects were identified by the political press and market participants well in advance.

Case Study from 2020: Stimulus Checks

After the dust cleared in 2020, it became clear that Joe Biden had won the Presidency and the Democrats had won the House of Representatives. However, Senate control was dead-locked: the Democrats had won 48 seats to the Republicans' 50, with two races in Georgia heading to a run-off. If Democrats won both, they would control the Senate (due to Vice President Kamala Harris holding the tiebreak vote).

Control of the Senate would be pivotal to President Biden's agenda. Democrats made the stakes clear: if they controlled the Senate, they would immediately use their trifecta to pass a major COVID-19 relief bill that includes \$2,000 stimulus checks for nearly all Americans.¹²³¹²⁴¹²⁵ If the Republicans won, those checks were unlikely (Senate Republican leader Mitch McConnell even called them "socialism for rich people" before blocking a vote on them in late 2020), as was confirmed when the bill (the American Rescue Plan Act) was ultimately passed on a pure party-line vote.¹²⁶¹²⁷¹²⁸

While the ultimate stimulus amount was pared down to \$1,400 per person, the bill also contained provisions such as \$350 billion in aid to state and local governments, a dramatic expansion in the

¹²¹ Robert Orr. 2019. "The impact of the 2017 Child Tax Credit expansion was larger than anyone expected." *Niskanen Center*.

¹²² Phil Kuntz. 2016. "4 days to go: Here's the US election cheatsheet for financial markets." *The Economic Times*.

¹²³ Kate Sullivan. 2021. "Biden says electing Georgia's Ossoff and Warnock would lead to \$2,000 stimulus checks." *CNN*.

¹²⁴ Sahil Kapur. 2021. "In Georgia, Democrats close with populist pitch vowing \$2,000 stimulus checks." *NBC News*.

¹²⁵ Lance Lambert and Anne Sraders. 2021. "Democrats plan to use Senate win to pass \$2,000 stimulus checks." *Fortune*.

¹²⁶ Burgess Everett and Quint Forgey. 2020. "McConnell: House's \$2,000 stimulus checks are 'socialism for rich'." *Politico*.

¹²⁷ Burgess Everett. 2020. "McConnell and GOP reject House's \$2,000 stimulus checks." *Politico*.

¹²⁸ H.R. 1319, 117th Congress. <https://www.congress.gov/bill/117th-congress/house-bill/1319/actions>

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child tax credit and an extension of emergency unemployment insurance policies that had been enacted earlier during the pandemic.¹²⁹ For millions of families with children or earning under \$75,000 per year (the income threshold for the stimulus checks), control of the Senate thus had a predictable impact on their household finances. Along with those who were unemployed, or had a job dependent on contracts with state and local governments, the Democratic trifecta may have been a factor in the drop in household debt and child poverty in the first half of 2021.¹³⁰¹³¹

As in the previous examples, these tradeoffs were known prior to the Democratic takeover. Senate Republican leadership was opposed to the American Rescue Plan Act and made that opposition plain. They not only opposed the checks, but the aid to states as well.¹³² Reasonable voters could reasonably infer that a Republican victory meant either no or a much smaller rescue bill. Control of the legislative branch thus has an impact on millions of Americans' financial situations.

¹²⁹ Erik Haagansen. 2021. "American Rescue Plan (Biden's \$1.9 Trillion Stimulus Package)." *Investopedia*.

¹³⁰ Household Debt Service Payments as a Percent of Disposable Personal Income. *Federal Reserve Economic Data*. <https://fred.stlouisfed.org/series/TDSP>

¹³¹ Zachary Parolina, Sophie Collyera, Megan A. Currana and Christopher Wimer. 2021. "Monthly Poverty Rates among Children after the Expansion of the Child Tax Credit." *Poverty and Social Policy Brief*.

¹³² Jason Lemon. 2020. "N.Y. Congressman Calls Out McConnell for Opposing COVID Aid to States." *Newsweek*.

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